Supreme Court of the United States

OCTOBER TERM, 1965

No. 535

UNITED STATES, PETITIONER

vs.

JOHN CATTO, JR., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

INDEX

	Original	Print
Record from the United States District Court, Western District of Texas, San Antonio Division		
Stipulation of facts, Civil Action No. 3060	1	1
Exhibit B—Special letter from the Secretary of the Treasury to Honorable Walter F. George, Chairman, Senate Finance Committee, dated June 27, 1952	11	9
Findings of fact and conclusions of law, Civil Action No. 3060	38	34
Judgment, Civil Action No. 3060	50	43
Notice of appeal, Civil Action No. 3060	52	44
Proceedings in the United States Court of Appeals for the Fifth Circuit	54	45

	Original	Print
Minute entry of argument and submission (omitted in printing)	54	45
Opinion, Per Curiam, Case No. 21351	55	46
Judgment, Case No. 21351	59	49
Clerk's certificate (omitted in printing)	60	49
Record from the United States District Court, Western District of Texas, Del Rio Division	3	50
Findings of fact and conclusions of law	3	51
Stipulation of facts, Civil Action No. 307	65	65
Exhibits R, S and T—Claims for Refunds with attached schedules	115	78
Final judgment, Civil Action No. 307	140	100
Notice of appeal, Civil Action No. 307	143	102
Proceedings in the United States Court of Appeals for the Fifth Circuit	153	103
Minute entry of argument and submission (omitted in printing)	153	103
Opinion, Per Curiam, Case No. 21607	154	104
Judgment, Case No. 21607	158	107
Clerk's certificate (omitted in printing)	159	108
Orders extending time to file petition for writ of certiorari	160	108
Order allowing certiorari	164	112

[fol. A]

[File Endorsement Omitted]

[fol. 1]

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

Civil Action No. 3060

JOHN CATTO, JR. AND ROXANA CATTO, his wife,
PLAINTIFFS

vs.

UNITED STATES OF AMERICA, DEFENDANT

STIPULATION OF FACTS

The parties to the above-entitled case, through their respective attorneys, agree that the following facts may be taken as true for the purpose of this action without further proof or foundation:

1. Plaintiffs, John Catto, Jr. and Roxana Catto, are husband and wife and at all times material hereto were residents of Bexar County, City of San Antonio, State of Texas.

2. During the years 1954 and 1955, and for many years prior and subsequent thereto, Plaintiffs were engaged in the ranching business. In connection with their ranching business, Plaintiffs own and operate two ranches in West Texas. One ranch, which is located in Brewster County, is known as the Marathon Ranch and consists of approximately 173,000 acres. The other ranch which is located in Presidio County, is known as the Marfa ranch and consists of approximately 20,000 acres. For a number of years Plaintiffs leased without interruption approximately 15,000 additional acres adjoining the Marfa Ranch. These ranches were originally owned and operated as a sole proprietorship by Plaintiff-Roxana Catto's father and

[fol. 2] mother, Mr. and Mrs. A. S. Gage. In 1924 Mrs. Gage died and devised her community one-half interest in the community estate in trust for the benefit of her two daughters (Plaintiff-Roxana Catto and her sister) with her husband as trustee. Thereafter the ranches were operated as an informal partnership by Mr. Gage in his capacity as trustee for his two daughters under Mrs. Gage's will and in his individual capacity. In 1928 Mr. Gage died; under his will his interest in the ranches was devised in trusts for ten years for the benefit of his two daughters (Plaintiff-Roxana Catto and her sister); the trustees appointed in his will were Warren Henderson and A. J. Roberts. For ten years, from 1928 to 1938, the ranch operations were conducted as a partnership by trustees. In 1938 the trusts and partnership were terminated. In that year Plaintiffs John and Roxana Catto were married. From 1938 to 1949 the ranching operations were conducted as a partnership between the two daughters (and their respective husbands). In September 1942 the Marathon ranch lands were partitioned between the daughters, and in June 1944 the Marfa Ranch lands were partitioned between the daughters; however, the ranching operations were continued at both ranches as a partnership by the daughters (and their respective husbands). On December 31, 1948, the partnership ranching operations at the Marathon ranch were terminated and equally divided between the daughters. Thereafter, the two daughters each had a separate ranch at Marathon and each ranch was operated separately on an individual basis. On December 31, 1951, the partnership ranching operations at the Marfa ranch were terminated and equally [fol. 3] divided between the daughters, who thereafter operated their respective portions separately. Since the termination of the partnership operations at the Marathon on December 31, 1948, and at the Marfa ranch on December 31, 1951, respectively, the Cattos have conducted their ranching operations as a sole proprietorship and maintained separate books and records and filed their tax returns on such basis. No partnership tax returns were filed for years after 1951.

3. The ranching business conducted by Plaintiffs consisted of breeding and raising cattle for the production

and sale of calves. Customarily the animals sold by the Plaintiffs are sent to the Midwest by purchasers for fattening and ultimate sale for beef or slaughter purposes. In connection with the ranching business Plaintiffs maintained a breeding herd of Hereford cattle. As circumstances required Plaintiffs purchased bulls and cows for addition to their breeding herd, to increase the herd, improve the quality and prevent inbreeding. Also, as circumstances required, the Plaintiffs selected certain calves produced from the breeding herd and added the same to the breeding herd. The number of animals to be retained in the breeding herd was determined on the basis of range conditions, rainfall, costs of operation and other factors. When required by age, disease and other circumstances, the Plaintiffs culled from the breeding herd and sold animals which were unfit for breeding stock or which for some other reason could not be retained. Calves produced by the breeding herd and not added to the breeding herd were sold in the due course of business.

4. Prior to 1920 the Gage ranches kept their books on the cash basis. In approximately 1920, as a result of an [fol. 4] examination of their income tax returns by the Internal Revenue department, Mr. and Mrs. A. S. Gage adopted the accrual (inventory) basis and commenced valuing their inventory of livestock under a unit-livestock-price method. Such method was continued by the various partnerships which operated the ranches up to 1938. When the two daughters (Plaintiff, Roxana Catto, and her sister), with their respective husbands, commenced operating the ranches as a partnership in 1938 they continued to use this method; and when the partnership operations were terminated and Plaintiffs commenced operation of their Marathon and Marfa ranches as a sole proprietorship, they used this method.

5. During the years 1954 and 1955, Plaintiffs kept their books and records on the accrual (inventory) and calendar year basis, and used the unit-livestock-price method of valuing inventory. In accordance with applicable Treasury Regulations, Plaintiffs included all livestock raised and held for sale in inventory. In addition, in accordance with the applicable Treasury Regulations, Plain-

tiffs included raised animals constituting the breeding herd and held by them for breeding purposes in inventory.

6. Under the unit-livestock-price method, Plaintiffs assigned to the various kinds, classifications and categories of raised breeding herd animals included in inventory in unit value. As such raised animals advanced in age, Plaintiffs accrued with respect to such animals the appropriate unit values. The kinds, classifications, categories and unit values assigned to raised breeding herd animals during the years 1954 and 1955 and prior thereto were [fol. 5] as follows:[1]

NON-REGISTER [2]	
Heifer yearlings	$ 25.00
Cows, two-year-old	30.00
Cows, three-year-old	35.00
Bulls	100.00

REGISTERED	
Calves	$ 50.00
Heifer yearlings	75.00
Cows	100.00
Bulls	100.00

7. The inclusion of the raised animals in inventory resulted in increasing the Plaintiffs' ordinary income in an amount equal to the value of the new animals included in inventory for the first time plus an amount equal to the annual increase in value for those animals already in inventory (because the increase in closing inventory de-

---

[1] The partnership between the two daughters (Plaintiff, Roxana Catto, and her sister) and their respective husbands began using these particular unit values on January 1, 1942, and continued to use them throughout the duration of the partnership. When Plaintiffs commenced operating the ranches as a sole proprietorship they used the same unit values.

[2] Other values for unregistered raised livestock which they used were as follows:

Steers—(yearling)	$27.50
Steers—1 year	30.00
Steers—2 years	40.00
Steers—3 years	50.00

creased "cost of goods sold").[3] If Plaintiffs were subject to ordinary income tax in that year, it resulted in increasing the ordinary income tax paid by them. On the other [fol. 6] hand, in the year such animals were sold the amount of income from the sale of the animals that was entitled to long-term capital gain treatment was reduced because Plaintiffs deducted, as a cost basis, the accrued inventory value from the sales price in order to compute the amount of profit to which the long-term capital gain rate would apply.

8. Within the time prescribed by law Plaintiffs duly made and filed with the District Director of Internal Revenue at Austin, Texas, their joint federal income tax returns for the calendar years 1954 and 1955, copies of which returns are attached hereto as exhibits 1(a) and 1(b), respectively.

9. In their joint federal income tax returns the Plaintiffs used as the cost basis of raised breeding herd animals sold during the years 1954 and 1955 the accrued unit values assigned to such animals in Plaintiffs' inventory rather than zero in determining the amount of gain from the sale of raised breeding herd animals under the provisions of Section 1231 of the Internal Revenue Code of 1954.

10. In said returns, in determining their closing inventory for the years 1954 and 1955, Plaintiffs did not make an adjustment to their closing inventory eliminating therefrom the accrued unit value of those raised breeding herd animals sold during the years 1954 and 1955.

11. In said returns, in determining their closing inventory for the years 1954 and 1955, Plaintiffs made an adjustment to their closing inventory in accordance with the applicable Treasury Regulations, whereby new raised [fol. 7] breeding herd animals were included in inventory at a unit value, and the unit value of raised breeding herd animals in inventory was increased.

---

[3] Under this method the taxpayers would include in inventory the yearling heifer at $25.00. This would mean an increase in ordinary income of $25.00. As to the same animal, in the following year the value would be increased to $30.00. This increment created a like amount of ordinary income to the extend of $5.00.

12. Thereafter, the Commissioner of Internal Revenue caused Plaintiffs' joint federal income tax returns for the years 1954 and 1955 to be examined and determined that there was a deficiency in income taxes due from Plaintiffs; said deficiency was attributable to adjustments presently not in controversy in this proceeding. On October 17, 1960, Plaintiffs paid to the District Director of Internal Revenue at Austin, Texas, the said deficiency plus statutory interest thereon.

13. On or about July 12, 1961, Plaintiffs duly filed a claim for refund in due and proper form with the District Director of Internal Revenue at Austin, Texas, for the recovery of $7,205.61, for the year 1954, and $46,650-73 for the year 1955, plus statutory interest thereon. A copy of said claim is attached to Plaintiffs' Complaint as Exhibit "A" and incorporated herein by reference as Exhibit "A".

14. Said claim for refund was based in part on the following grounds:

(1) That the applicable Treasury Regulations requiring Plaintiffs to include raised breeding herd animals in inventory are contradictory to the provisions of Section 1231 of the Internal Revenue Code of 1954 and are invalid and of no force and effect.

(2) That in determining taxable income for the years 1954 and 1955 Plaintiffs were entitled to do [fol. 8] the following in order to correct an error caused by the Treasury Regulations:

(a) Use zero as the cost basis of raised breeding herd animals sold during such years rather than the accrued unit value assigned to such animals in determining the amount of gain under the provisions of Section 1231 of the Internal Revenue Code of 1954.

(b) Make an adjustment to their closing inventory for such years eliminating therefrom the accrued unit value of raised breeding herd animals sold during such years.

(c) Make an adjustment to their closing inventory for such years eliminating therefrom the

unit value of those raised breeding herd animals included in inventory for the first time in such years and not sold, and the increase in the unit value of those raised breeding herd animals in inventory from previous years and not sold during such years.

(3) That such adjustments do not constitute a change in accounting methods, and therefore, Plaintiffs were not required to request and obtain the Commissioner's consent thereto.

(4) That it would have been useless for Plaintiffs to file a request to change accounting methods with the Commissioner as no consideration would have been given thereto.

15. More than six months elapsed between the filing of Plaintiffs' claim for refund and the filing of Plaintiffs' [fol. 9] complaint in this proceeding, and the District Director of Internal Revenue neither rejected said claim nor paid it during such period of time.

16. The amount of Federal income taxes involved in this proceeding for the years 1954 and 1955 is $2,118.50 and $14,142.39, respectively. The computation of such amounts is set forth in Appendix I which is attached hereto and made a part hereof.

17. During the years 1954 and 1955 and prior and subsequent thereto up to and including the present time the Commissioner of Internal Revenue did not require inclusion in inventory of raised breeding herd animals on the part of ranchers who maintained breeding herds and kept their books and filed their federal income tax returns on the cash receipts and disbursements method of accounting.

18. During the years 1954 and 1955 and prior thereto Plaintiffs did not file a request to change from the accrual (inventory) method of accounting to the cash receipts and disbursements method with the Commissioner of Internal Revenue and the Commissioner has not consented to a change in accounting methods.

19. During the years 1954, 1955, 1956, 1957, and 1958, it was the policy of the Commissioner of Internal Revenue not to consider requests filed by ranchers to change from

the accrual (inventory) method of accounting for Federal income tax purposes to the cash receipts and disbursements method until the final regulations under the Internal Revenue Code of 1954 were issued.

[fol. 10] 20. Attached as Exhibit "B" is a true copy of a letter from the Secretary of the Treasury dated June 27, 1952, to the Chairman of the Senate Finance Committee. Plaintiffs reserve the right to object to the relevancy or materiality of this document.

FOSTER, LEWIS, LANGLEY
& ONION
Eighteenth Floor Milam Building
San Antonio 5, Texas

By /s/ GORDON G. HAWN
Attorney for Plaintiffs

/s/ JOHN A. BAILEY,
Attorney for Defendant

[fol. 11]

EXHIBIT "B" TO STIPULATION OF FACTS

APPENDIX B

Special Letter of June 27, 1952, from the Secretary of the Treasury to Honorable Walter F. George, Chairman, Senate Finance Committee (1952 C.C.H., Par 6239):

My Dear Senator: The Commissioner of Internal Revenue has called to my attention a tax situation which deserves serious legislative consideration. The problem is of such importance that I feel it should promptly be brought to the attention of the Congressional Committees concerned with taxation. For this reason I am writing to you and am sending a similar letter to Representative Doughton.

The problem arises from a combination of two circumstances:

1. The long-continued administrative practice of permitting farmers to take current expense deductions for the cost of raising livestock held for draft, breeding, or dairy purposes; and

2. The recently developed capital-gain treatment of profits upon the sale of livestock held for those purposes.

Taxpayers have always been required to capitalize, rather than to deduct currently, the cost of buildings, machinery, equipment, and other types of property used in the conduct of a trade or business and subject to the allowance for depreciation. Since livestock used by a farmer for draft, breeding, or dairy purposes is property used in his trade or business
[fol. 12] and subject to the allowance for depreciation, farmers have long been required to capitalize the cost of animals purchased for those purposes.

However, since the early days of the income tax, the regulations have permitted farmers to take current expense deductions for the cost of raising livestock intended for draft, breeding, or dairy purposes. The apparent reason for this regulation, which was introduced before favorable tax treatment had been granted to capital gains, was that the cost of raising

an animal to maturity might be difficult to ascertain, particularly since the Bureau of Internal Revenue did not at that time recognize methods of approximately such costs. Since the sales price of the animal then represented ordinary income the regulation resulted in no loss of revenue to the Government. For more than 20 years after the provisions favoring capital gains were introduced into the income law (in the Revenue Act of 1921), this method continued to produce acceptable results since gain upon the sale of livestock from dairy breeding or breeding herds was consistently treated as ordinary income.

However, the treatment of profits upon the sale of such animals as ordinary income has gradually been departed from in recent years. The first step in this direction was the issuance in 1944 and 1945 of two rulings by the Bureau of Internal Revenue (IT 3666, C. B. 1944, p. 270, and IT 3712, C. B. 1945, p. 176), developed with the assistance of representatives of livestock associations. These rulings granted capital-gains treatment to unusual sales which reduced the
[fol. 13] size of the breeding or dairy herd, but not to routine sales of culled animals. The second step was a series of court decisions, beginning with that in *Albright* v. *United States* (CA-8, 1949), 173 F. 2d 339 [49-1 USTC] [9215], which went beyond the published rulings and extended capital gains treatment to routine sales of animals culled from dairy or breeding herds. The third and latest step was the 1951 legislation sec. 324 of the Revenue Act of 1951, amending sec. 117 (j) (1) of the Internal Revenue Code) designed to restate and clarify the results of the court decisions. This legislation provided that profits from the sale of "livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more" should be eligible for capital-gains treatment.

The interaction of (1) the regulation permitting deduction of costs of raising livestock, added to a dairy or breeding herd and (2) the granting of capital-gains treatment upon the sale of such livestock is

best shown by an example. Assume that a farmer raises to maturity, at a cost of $100 an animals which he places in a dairy or breeding herd. Later the animal is culled from the herd and sold for $150. The farmer's profit is $50, which should be taxed as capital gain. However, the farmer is able to take the $100 cost as a current deduction to offset $100 of otherwise taxable income. If he is using the cash receipts and disbursements method of accounting, the basis of the animal is then treated as zero, and the whole of the sales price (150) is treated as capital
[fol. 14] gain. Only one-half of the sales price, or $75, is included in net income, which is less than the $100 previously deducted. This profitable transaction not only escapes tax completely but is actually permitted to create a tax loss which decreases the amount of the farmer's taxable income from other transactions.

This situation is creating a serious distortion in taxable income. Obviously, the larger the scale of the taxpayer's business, the more serious is the distortion. Applying the figures of the above example to a rancher who adds 200 head of cattle annually to his breeding herd, it will be seen upon computation that the taxpayer's income would be distorted downward by $10,000 annually.

The adverse effect of this situation upon the revenue can be estimated from department of Agriculture statistics which indicate that there are about 44,000,000 mature cows in this country, 23,400,000 being held for dairy purposes and 20,600,000 for the production of beef calves. It would be conservative to estimate that one-eighth of these cows, or 5,500,000 head, are sold annually. If the average cost of raising a cow to maturity is assumed to be $100, the expensing of the cost would distort taxable income downward by $275,000,000 a year. This figure would be increased if pigs, sheep, and other livestock were taken into consideration.

These revenue considerations are important. However, what makes the situation even more serious is that almost intolerable inequities have been created

among farmers and ranchers using different account-
[fol. 15] ing methods. The windfall which has been illustrated is being shared only by those farmers and ranchers who file returns upon the cash receipts and disbursements methods of accounting. This discriminates heavily against farmers and ranchers who use the accrual method of accounting. The general practice of the latter group is to inventory the animals raised for draft, breeding, or dairy purchases at round figures representing the estimated costs normally incurred in raising animals of the particular age and class. Therefore, if the farmer on the accrual basis raises at a cost of $100 an animal for addition to his dairy or breeding herd and later sells the animal for $150, he will pay a tax upon one-half of the gain (that is, upon $25).

The result is that farmers and ranchers using the accrual basis are now paying tax on the true amounts of their capital gains, whereas those on the cash basis are receiving windfalls which not only wipe out their capital gains but also a part of their income from other sources.

In three recent instances the Congress, upon recommendation of your committee, has enacted remedial legislation to prevent actual gains from being converted into tax losses. First, in section 211 of the Revenue Act of 1950, legislation was enacted to prevent short sales from being used for that purpose. Secondly, in section 322 of the Revenue Act of 1951, the method of offsetting short-term and long-term capital gains and losses was changed in order to prevent profits of speculators or investors from taking
[fol. 16] on the appearance of tax losses. Thirdly, in section 323 of the Revenue Act of 1951, the costs of growing unharvested crops which were sold with the land at capital-gain rates were required to be capitalized in order to prevent tax windfalls. The livestock situation falls in this same general category; moreover, the existing inequity between users of the cash basis and users of the accrual basis presents an additional reason for legislative action.

It is estimated that perhaps 75 percent of the cattle ranchers are now on the accrual basis and that a relatively small percentage of the farmers who raise some dairy or breeding cattle are also on that basis. Since the accrual basis reflects income more accurately and is helpful in preventing a bunching of income when the size of the herd is reduced, the Department of Agriculture and the livestock associations have for years been encouraging the use of that method.

However, the windfall now available to users of the cash basis has led to a large and increasing number of requests from farmers and ranchers now on the accrual basis for permission of the Bureau of Internal Revenue to change to the cash basis. In 1951 about 45 such requests were received, all of which were denied. At the present time there are 200 such requests pending and the number continues to grow.

As you know, a taxpayer can change his accounting method only if he receives permission from the Commissioner of Internal Revenue. Obviously, it is the duty of the Commissioner of Internal Revenue to deny the requests of the livestock raisers to change from the accrual to the cash basis, (1) because the [fol. 17] accrual basis now being used by them better reflects their income than the cash basis which they desire to use, and (2) because the requests are not being made for any business reason but solely in order to obtain a tax windfall. Moreover, the change requested by these tax payers is inhibited by the report of your committee upon the Revenue Act of 1951, stating the belief of your committee that gains from sales of livestock should be computed "in accordance with the method of livestock accounting used by the taxpayer and presently recognized by the Bureau of Internal Revenue." For these reasons, it has been decided that, consistent with the action taken upon the requests last year, the sending requests are to be denied.

However, even though it is clearly the Commissioner's duty to deny these requests, this action will prolong the serious inequity which has been described

unless action is taken to eliminate the windfall now being enjoyed by the users of the cash basis. Consideration has been given to elimination of this windfall by an exercise of the administrative authority to prescribe accounting methods. This course of action has been carefully explored in conferences with the representatives of the livestock association and of the Department of Agriculture. However, the conclusion has been reached that administrative action to eliminate the windfall is undesirable in view of the report of your committee referred to above. It has been urged that this report, to the effect that gains from sales of livestock should be computed in accordance with "the method of livestock accounting [fol. 18] used by the taxpayer and presently recognized," prevents amending the regulations to require capitalization of the cost of raising livestock held for draft breeding or dairy purposes.

This Department has given careful consideration to the development of a method of capitalization which will not require detailed record keeping on the part of farmers. It would be feasible to permit farmers to use as their costs for tax purposes a round amount representing the estimated normal cost of raising animals of the particular age and class. This is similar to the so-called unit-livestock-price method of inventory now permitted to accrual basis ranchers and farmers. Once a reasonable figure is established, it could be permitted to remain undisturbed for 5 years or more in the absence of noticeable changes in costs of feed, labor, etc. It is recognized that farmers in different parts of the country may have different costs and the Bureau of Internal Revenue would be expected to permit some tolerance. A farmer who does his own work and raises his own feed would have little, if any, cost to capitalize, since only the outlay of cash or its equivalent would be taken into consideration. All in all, it is believed that this system will present no greater difficulty in bookkeeping than the presently required capitalization

of the cost of purchased animals, farm machinery and equipment, and farm improvements.

Since there is disagreement as to the existence of administrative authority to eliminate the windfall and resulting inequity, legislative action appears to be the wisest course. Therefore, your committee will [fol. 19] need to give consideration to the approval of legislation to require capitalization of the cost of raising livestock held for draft, breeding, or dairy purposes. This would bring the tax treatment of raisers of such livestock who use the cash basis into line with the treatment of those who use the accrual basis and with the treatment of farmers and ranchers who purchase livestock for such use.

In order to avoid retroactive hardship, only future costs of raising animals for draft, breeding, or dairy purposes should be required to be capitalized. For convenience, the new rule might be applied only to taxable years beginning after the date of new legislation. Mature animals in the herd would then retain their existing basis; that is, if they were raised by the taxpayer and a zero basis they will retain that basis. Only the costs of raising the growing animals during future taxable years would be capitalized. In this manner, the taxpayer would gradually change into the new treatment and retain the advantages of whatever basis he had in the past.

In view of the foregoing, it is clear that this matter requires legislative consideration not only for the protection of the revenues but also in the interest of equity among taxpayers. The Department recognizes, however, that because of the complex nature of this problem and the heavy calendar already facing this Congress it may be necessary to defer legislative consideration until early next year. Nevertheless, in view of widespread interest in this matter, it is considered desirable that the Department's position be made known without delay.

JOHN CATTO, JR., AND ROXANA G CATTO
APPENDIX I—SUMMARY OF INCOME TAXES TO BE REFUNDED AS RESULT OF COURT'S FINDING FOR PLAINTIFF ON LEWIS - EKBERG ISSUE

Years 1954 and 1955

	Income Tax Previously Paid - Per RAR	Income Tax Refunded as Result of Settlement of Issues other Than Lewis - Ekberg	Balance	Income Tax as Result of Court's Finding for Taxpayer on Lewis - Ekberg Issue (Appendix Ia and Ie)	Additional Income Tax To be Refunded
Year 1954	5,430.41	3,311.91	2,118.50	—0—	2,118.50
Year 1955	42,867.63	11,997.27	30,870.36	16,727.97	14,142.39
Total income tax to be refunded as result of Court's finding for plaintiff on Lewis - Ekberg issue					16,260.89

[fol. 21]

JOHN CATTO, JR., AND ROXANA G. CATTO
APPENDIX Ia - RECOMPUTATION OF INCOME TAX
LIABILITY AS RESULT OF COURT'S FINDING FOR

PLAINTIFF ON LEWIS - EKERG ISSUE

Year 1954

Taxable income per Revenue Agent's Report dated January 20, 1958		21,086.91
Less:		
(1) Gain on sale of breeding herd animals erroneously treated as ordinary income in Revenue Agent's Report		
Total gain on sale of heifer 1s - per RAR	27,338.76	
Less gain on sales prior to May 1, 1954 - per RAR	6,152.50	
Gain on sale of heifer is erroneously treated as ordinary income in RAR	21,186.26	
50% thereof		10,593.13

Taxable income - before adjustment for correction of inventories (Lewis - Ekberg issue)		
Less:		10,493.78
(2) Decrease in taxable income resulting from correction of inventory of raised breeding herd animal - Appendix Ib		19,329.00
(3) Decrease in taxable income resulting from elimination from cost basis in determining gain on sale of raised breeding herd animals the values assigned to such animals under the unit- livestock-price method of valuing livestock for inventory, and corresponding adjustment to inventory - Appendix Ic	33,945.00	
50% thereof		16,972.50
Plus:		(25,807.72)
(4) Decrease in contributions allowable - Appendix Id		3,587.00
		(22,220.72)
Taxable income (loss) - as adjusted		
Income tax - as adjusted		—0—

JOHN CATTO, JR., AND ROXANA G. CATTO
APPENDIX Ib - DETAIL OF INVENTORY OF LIVESTOCK AT DECEMBER 31, 1954 AND COMPUTATION OF DECREASE IN TAXABLE INCOME RESULTING FROM CORRECTION OF INVENTORY OF RAISED BREEDING HERD ANIMALS

Year 1954

	NUMBER OF HEAD	UNIT VALUATION	TOTAL
Raised breeding herd animals:			
Cows	1,922	35.00	67,270.00
Cows 2s	500	30.00	15,000.00
Heifers 1s	606	25.00	15,150.00
Bulls	23	100.00	2,300.00
Cows - registered	14	100.00	1,400.00
Heifers - registered	9	100.00	900.00
Bulls - registered	20	100.00	2,000.00
Calves - registered	18	50.00	900.00
Ewes	540	5.00	2,700.00

Total raised breeding herd animals - at valuation as reported in income tax return		107,620.00
Other livestock inventories (not at issue)		122,704.54
Total inventory - as reported in income tax return		230,324.54
Decrease in inventory of raised breeding herd animals to arrive at corrected inventory (after 15% discount) - see below		19,329.00
Inventory as corrected - at December 31, 1954		210,995.54

Computation of Decrease in Inventory of Raised Breeding Herd Animals Due to Elimination of Increases and Additions to Unit Valuation in 1954

(1) Valuation of 418 of these cows was erroneously increased by $5 each (from $30 to $35) in determining above inventory - 418 x $5=	2,090.00
(2) Valuation of these 500 cows 2s was erroneously increased by $5 each (from $25 to $30) in determining above inventory - 500 x $5=	2,500.00

(3) These 606 heifer 1s were erroneously included for $25= the first time in above inventory at $25 each - 606 x	15,150.00
(4) Valuation of these 14 cows was erroneously increased by $25 each (from $75 to $100) in determining above inventory - 14 x $25=	350.00
(5) Valuation of these 9 heifers was erroneously increased by $50 each (from $50 to $100) in determining above inventory - 9 x $50=	450.00
(6) Valuation of 2 of these bulls was erroneously increased by $50 each (from $50 to $100) in determining above inventory - 2 x $50=	100.00
(7) These 18 calves were erroneously included in the above inventory for the first time at $50 each - 18 x $50=	900.00

JOHN CATTO, JR., AND ROXANA G. CATTO

APPENDIX Ib - DETAIL OF INVENTORY OF LIVESTOCK AT DECEMBER 31, 1954 AND COMPUTATION OF DECREASE IN TAXABLE INCOME RESULTING FROM CORRECTION OF INVENTORY OF RAISED BREEDING HERD ANIMALS

(continued)

Year 1954

Computation of Decrease in Inventory of Raised Breeding Herd Animals Due to Elimination of Increases and Additions to Unit Valuation in 1954

(continued)

(8) 240 of these ewes were erroneously included for the first time in the above inventory at $5 each - 240 x $5=	1,200.00
Decrease in inventory to arrive at corrected inventory	22,740.00

Less amount discounted (15%)	3,411.00
Decrease in taxable income resulting from correction of inventory of raised breeding herd animals	19,329.00

JOHN CATTO, JR., AND ROXANA G. CATTO
APPENDIX Ic - UNIT VALUES ASSIGNED TO RAISED BREEDING HERD ANIMALS SOLD IN 1954 WHICH QUALIFY UNDER CODE SECTION 1231

	UNIT VALUE ASSIGNED
Raised breeding herd animals sold in 1954 which qualify for capital gain treatment under Code Section 1231:	
682 cows 3s and up	23,870.00
35 cows 2s	1,050.00
12 bulls	1,200.00
313 hiefers 1s	7,825.00
Total	33,945.00

JOHN CATTO, JR., AND ROXANA G. CATTO
APPENDIX Id - RECOMPUTATION OF CONTRIBUTIONS ALLOWABLE

Year 1954

Adjusted gross income per RAR dated January 20, 1958		30,539.35
Less:		
Adjustments thereto:		
Adjustment (1), Appendix Ia	10,593.13	
Adjustment (2), Appendix Ia	19,329.00	
Adjustment (3), Appendix Ia	16,972.50	46,894.63
Adjusted gross income - as adjusted		(16,355.28)
Contributions allowable as adjusted		—0—
Contributions allowable per RAR dated January 20, 1958		3,587.00
Decrease in contributions allowable		3,587.00

JOHN CATTO, JR., AND ROXANA G. CATTO
APPENDIX Ie - RECOMPUTATION OF INCOME TAX LIABILITY AS RESULT OF COURTS FINDING FOR PLAINTIFF ON LEWIS - EKBERG ISSUE

Year 1955

Taxable income per RAR dated January 20, 1958			90,515.51
Less:			
(1) Gain on sale of breeding herd animals erroneously treated as ordinary income in RAR			
Total gain on sale of heifer 1s per RAR	25,010.65		
Less gain on sales prior to May 1, 1955- per RAR	20,950.34		
		4,060.31	
Gain on sale of heifer 1s erroneously treated as ordinary income in RAR	41,515.00		
Total gain on sale of cows 2s per RAR	x 70%	29,060.50	
Gain on sale of breeding herd animals erroneously treated as ordinary income in RAR		33,120.81	
50% thereof			16,560.40

[fol. 30]

Taxable income - before adjustment for correction of inventories (Lewis - Ekberg issue)			73,955.11
Less:			
(2) Decrease in taxable income resulting from correction of inventory of raised breeding herd animals - Appendix If		16,379.50	
(3) Decrease in taxable income resulting from elimination from cash basis in determining gain on sale of raised breeding herd animals the values assigned to such animals under the unit-livestock-price method of valuing livestock for inventory, and corresponding adjustment to inventory - Appendix Ig	25,177.00		
50% thereof		12,588.50	28,968.00
Taxable income - as adjusted			44,987.11
Income tax thereon:			
Ordinary method (joint return)		17,342.39	
Alternative method - not applicable			
Less dividend received credit (per RAR)		614.42	
Income tax - as adjusted		16,727.97	

[fol. 31]

JOHN CATTO, JR., AND ROXANA G. CATTO
APPENDIX If - DETAIL OF INVENTORY OF LIVESTOCK AT DECEMBER 31, 1955, AND COMPUTATION OF DECREASE IN TAXABLE INCOME RESULING FROM CORRECTION OF INVENTORY OF RAISED BREEDING HERD ANIMALS

Year 1955

		NUMBER OF HEAD	UNIT VALUATION	TOTAL
Raised breeding herd animals:				
Cows	(1)	1,598	35.00	55,930.00
Cows 2s	(2)	226	30.00	6,780.00
Heifers 1s	(3)	787	25.00	19,675.00
Cows - registered		14	100.00	1,400.00
Heifers - registered	(4)	34	100.00	3,400.00
Bulls - registered	(4)	33	100.00	3,300.00
Calves - registered	(4)	33	75.00	2,475.00
Calves - registered	(4)	34	50.00	1,700.00
Ewes	(5)	914	5.00	4,570.00

Total raised breeding herd animals - at valuation as reported in income tax return		99,230.00
Other livestock inventories (not at issue)		161,990.00
Total inventory - as reported in income tax return		261,220.00
Decrease in inventory at December 31, 1954, which is also applicable to December 31, 1955, inventory - see below	8,002.75	
Decrease in inventory of raised breeding herd animals to arrive at corrected inventory - see below	27,705.75	35,708.50
Inventory as corrected - at December 31, 1955		225,511.50

[fol. 33]

Computation of Decrease in Closing Inventory of Raised Breeding Herd Animals for Elimination of Increases and Additions to Unit Valuation in 1954 - for Animals Still on Hand at December 31, 1955

Decrease in inventory of raised breeding herd animals at December 31, 1954	22,740.00		
Less amount discounted (15%)	3,411.00	19,329.00	
Less: Animals no longer on hand at December 31, 1955:			
475 cows 2s @ $5	2,375.00		
380 heifers 1s @ $25	9,500.00		
9 heifers @ $50	450.00		
18 calves @ $50	900.00		
20 ewes @ $5	100.00		
	13,325.00		
Less amount discounted (15%)	1,998.75	11,326.25	
Decrease in inventory at December 31, 1954, which is also applicable to December 31, 1955, inventory above - for computation purposes			8,002.75

Computation of Decrease in Inventory of Raised Breeding Herd Animals Due to Elimination of Increases and Additions to Unit Valuations in 1955

(2) Valuation of these 226 cows 2s was erroneously increased by $5 each in determining above inventory- 25 x $5	125.00
(2) Valuation of these 226 2s cows was erroneously increased by $5 each in determining above inventory-	
226 x $5	1,130.00

JOHN CATTO, JR., AND ROXANA G. CATTO
APPENDIX If - DETAIL OF INVENTORY OF LIVESTOCK AT DECEMBER 31, 1955, AND COMPUTATION OF DECREASE IN TAXABLE INCOME RESULTING FROM CORRECTION OF INVENTORY OF RAISED BREEDING HERD ANIMALS

(continued)

Year 1955

Computation of Decrease in Inventory of Raised Breeding Herd Animals Due to Elimination of Increases and Additions to Unit Valuations ni 1955 (continued)

(3)	These 787 heifers 1s were erroneously included for the first time in above inventory at $25 each - 787 x $25	19,675.00
(4)	These registered animals were erroneously included for the first time in above inventory at $100 each -	

34 x $100	3,400.00		
20 x $100	2,000.00		
33 x $75	2,457.00		
34 x $50	1,700.00		
(5) 418 of these ewes were erroneously included for the first time in above inventory at $5 each - 418 x $5	2,090.00		
Decrease in inventory to arrive at corrected inventory	32,595.00		
Less amount discounted (15%)	4,889.25		
Decrease in closing inventory to arrive at corrected inventory for computation purposes		27,705.75	
Total decrease in closing inventory for computation purposes		35,708.50	
Less decrease in opening inventory - per Appendix Ib		19,329.00	
Decrease in taxable income resulting from correction of inventory of raised breeding herd animals			16,379.50

JOHN CATTO, JR., AND ROXANA G. CATTO
APPENDIX Ig - UNIT VALUES ASSIGNED TO RAISED BREEDING HERD ANIMALS SOLD IN 1955 WHICH QUALIFY UNDER CODE SECTION 1231

		UNIT VALUES ASSIGNED
Raised breeding herd animals sold in 1955 which qualify for capital gain treatment under Code Section 1231:		
276 cows 3s and up		9,660.00
38 cows 2s		1,140.00
30 bulls		3,000.00
4 heifers (registered)		400.00
72 heifers 1s		1,800.00
437 cows 2s	13,110.00	
	x 70%	9,177.00
Total		25,177.00

[fol. 38]

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

Civil Action No. 3060

JOHN CATTO, JR. AND ROXANA CATTO, his wife

v.

UNITED STATES OF AMERICA

FINDINGS OF FACT AND CONCLUSIONS OF LAW—
September 30, 1963

The above-entitled action was brought by Plaintiffs against Defendant for the recovery of income taxes and interest thereon heretofore assessed against and collected from Plaintiffs by Defendant. After the Defendant answered the Plaintiffs and Defendant made and entered into stipulations of fact. There being no dispute as to any material fact and the suit involving a question of law, the case came on for trial in the United States District Court for the Western District of Texas, San Antonio Division, on the 3rd day of May, 1963, for oral argument and submission to the Court. The Court having considered the Stipulation of Facts entered into between the Plaintiffs and Defendant, the briefs submitted to the Court by the parties, and the arguments of counsel, upon the entire record, now makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

(1) All the material facts herein have been stipulated and the Stipulations of Facts entered into between Plaintiffs and Defendant are hereby found as stipulated and incorporated herein.

[fol. 39] (2) This action is for the recovery of income taxes and interest herefore assessed against and collected from Plaintiffs by Defendant and is brought under Title 28, U. S. Code Ann., Section 1346 (a) (1) as amended and under the Internal Revenue Code of 1954.

(3) Plaintiffs are husband and wife and at all times material hereto were residents of Bexar County, City of San Antonio, State of Texas.

(4) During the years 1954 and 1955 (the years involved in this proceeding) and for many years prior thereto, Plaintiffs were engaged in the ranching business. In connection therewith Plaintiffs owned and operated two ranches in West Texas. One ranch, which is located in Brewster County, is known as the Marathon Ranch and consists of approximately 173,000 acres. The other ranch, which is located in Presidio County, is known as the Marfa Ranch and consists of approximately 20,000 acres.[1]

[fol. 40] (5) The ranching business conducted by Plaintiffs consisted of breeding and raising cattle for the production and sale of calves. Customarily the animals sold by the Plaintiffs are sent to the Midwest by purchasers for fattening and ultimate sale for beef or slaughter pur-

---

[1] These ranches were originally owned by Plaintiff-Roxana Catto's father and mother, Mr. and Mrs. A. S. Gage. In 1924 Mrs. Gage died and devised her community one-half interest in the community estate in trust for the benefit of her two daughters (Plaintiff-Roxana Catto and her sister) with her husband as trustee. Thereafter the ranches were operated as an informal partnership by Mr. Gage in his capacity as trustee for his two daughters under Mrs. Gage's will and in his individual capacity. In 1928 Mr. Gage died; under his will his interest in the ranches was devised, in trusts for ten years for the benefit of his two daughters (Plaintiff-Roxana Catto and her sister). The trustees operated the ranches as a partnership until 1938 when the trusts and partnership were terminated. Thereafter, Plaintiff-Roxana Catto, her sister and their respective husbands operated the ranches as a partnership. On December 31, 1948 the partnership operations at the Marathon Ranch were terminated and equally divided between the daughters, and thereafter, each daughter owned and operated a separate ranch at Marathon. On December 31, 1951, the partnership operations at the Marfa Ranch were terminated and equally divided between the two daughters who thereafter operated their respective portions separately.

poses. In connected with the ranching business Plaintiffs maintained a breeding herd of Hereford cattle. As circumstances required, Plaintiffs purchased bulls and cows for addition to their breeding herd, to increase the herd, improve the quality and prevent in breeding. Also as circumstances required, the Plaintiffs selected certain calves produced from the breeding herd and added the same thereto. The number of animals to be retained in the breeding herd was determined on the basis of range conditions, rainfall, costs of operation and other factors. When required by age, disease and other circumstances, the Plaintiffs culled from the breeding herd and sold animals which were unfit for breeding stock or which for some other reason could not be retained. Calves produced by the breeding herd and not added to the breeding herd were sold in the due course of business.

(6) For each of the years here involved, Plaintiffs kept their books and records and filed their federal income tax returns on the accrual (inventory) and calendar year basis, and used the unit-livestock-price method of valuing inventory. Plaintiffs, either as member of a partnership operating the ranches or as sole proprietors, have been using the accrual (inventory) method for keeping [fol. 41] their books and records and valuing inventory under the unit-livestock-price method since 1938.[2]

(7) Under Treasury Regulation 1.471.6 (f), (and its predecessors), a taxpayer valuing inventory under the unit-livestock-price method is required to include raised breeding animals as well as animals held for sale in the ordinary course of business in inventory at a unit value. Under said Treasury Regulation (and its predecessors)

---

[2] This method was first adopted by Plaintiff-Roxana Catto's father and mother in approximately 1920 and was continued by the various partnerships which operated the ranches until 1938. When Plaintiff-Roxana Catto, her sister and their respective husbands commenced operating the ranches as a partnership they continued to use this method; and when the partnership operations were terminated and the Plaintiffs began operating their part of the ranches as a sole proprietorship at the end of 1948 and 1951 they continued to use this method.

as such animals advance in age the taxpayer is required to increase the unit values thereof.[3]

(8) For each of the years here involved as well as for each of the years prior thereto, Plaintiffs as required by the Treasury Regulations included their raised breeding animals in their inventory along with animals raised and held for sale in the ordinary course of business and valued such raised breeding animals under the unit-livestock-price method in accordance with the Treasury Regulations.

[fol. 42] (9) For each of the years here involved as well as for each of the years prior thereto, the inclusion of raised breeding animals in Plaintiffs' livestock inventory as required by the Treasury Regulations, and the valuation thereof under the unit-livestock-price method as provided in the Treasury Regulations resulted in increasing Plaintiffs' ordinary income for each of such years in an amount equal to the unit value assigned to each new raised breeding animal included in inventory for the first time, plus an amount equal to the annual increase in unit value for the raised breeding animals previously included in inventory.[4] If Plaintiffs were subject to ordinary income tax in that year, it resulted in increasing the ordinary income tax paid by them. On the other hand,

---

[3] The kinds, classifications, categories and unit values assigned to raised breeding herd animals during the years 1954 and 1955 and prior thereto were as follows:

NON-REGISTERED		REGISTERED	
Heifer yearlings	$ 25.00	Calves	$ 30.00
Cows, two-year-old	30.00	Heifer yearlings	75.00
Cows, three-year-old	35.00	Cows	100.00
Bulls	100.00	Bulls	100.00

The partnership between Plaintiff-Roxana Catto, her sister and their respective husbands began using these particular unit values on January 1, 1942, and continued to use them throughout the duration of the partnership. When Plaintiffs commenced operating the ranches as a sole proprietorship they used the same unit values.

[4] Under this method the Plaintiffs would include in inventory the yearling heifer at $25.00. This would mean an increase in ordinary income of $25.00. As to the same animal, in the following year the value would be increased to $30.00. This increment created a like amount of ordinary income to the extent of $5.00.

in the year such animals were sold the amount of profit from the sale that was entitled to capital gain treatment was reduced because Plaintiffs were required to deduct, as the cost basis, the accrued inventory value from the sales price in order to compute the amount of profit to which the capital gain rate would apply.

(10) During the years involved herein, and prior and subsequent thereto up to and including the present time, the Commissioner of Internal Revenue did not, and does not, require ranchers who maintain breeding herds and file their Federal tax returns on the cash receipts and disbursements basis to include raised breeding herd animals in inventory.

[fol. 43] (11) In each of the years here involved, as well as in the previous years, Plaintiffs culled and sold from their breeding herd, animals (including raised animals) which had been held and used by them for breeding purposes and had been held my them for more than twelve months before the date of such sales but which were unfit for breeding purposes or which for other reasons were not suitable or desirable for retention in their breeding herds.

(12) In filing their Federal income tax returns for each of the years here involved, the Plaintiffs, in determining the amount of gain from the sale of raised animals which had been held and used by them for breeding purposes and had been held by them for more than twelve months before the date of such sales, used the accrual unit inventory value assigned to such animals as the basis. In filing said returns, plaintiffs, also in accordance with the applicable Treasury Regulations, included new raised breeding herd animals in inventory at a unit value and increased the unit value of raised breeding herd animals in inventory.

(13) The Commissioner of Internal Revenue caused Plaintiffs' Federal income tax returns for the years here involved to be examined and determined that there was a deficiency in income taxes due from plaintiffs; said deficiency was attributable to adjustments presently not in controversy in this proceeding. On October 17, 1960, Plaintiffs paid to the District Director of Internal Revenue at Austin, Texas, the said deficiency plus statutory interest thereon.

(14) Thereafter, Plaintiffs duly filed claims for re-
[fol. 44] fund in due and proper form with the District Director of Internal Revenue at Austin, Texas, for the recovery of income taxes overpaid for the years involved herein. Said claim was neither rejected nor paid and after the expiration of six months Plaintiffs filed the complaint in this proceeding.

(15) During the years involved herein Plaintiffs did not file a request to change from the accrual (inventory) method of accounting to the cash receipts and disbursement method with the Commissioner of Internal Revenue. During such years the Commissioner would not consider a request of a rancher or farmer to change from the accrual (inventory) method of accounting to the cash receipts and disbursements.

(16) In their claims for refund and in this proceeding Plaintiffs claim:

> 1. That Treasury Regulation Section 1.471-6(f), and its predecessor, requiring Plaintiffs to include raised breeding herd animals in inventory, are contradictory to Section 1231 of the Internal Revenue Code of 1954 which provides that livestock held for draft, dairy or breeding purposes constitutes property used in the trade or business, and that they are, therefore, invalid and of no force and effect.
>
> 2. That Plaintiffs are entitled to remove from inventory raised breeding animals included in inventory in compliance with the said Treasury Reg-
> [fol. 45] ulation in order to correct an error caused by the Regulation.[5]

---

[5] The removal of such animals from inventory would be accomplished by:

(1) Adjusting closing inventory in the years involved eliminating therefrom an amount equal to the accrued unit value of raised breeding animals sold during such years; and,

(2) Adjusting closing inventory in the years involved eliminating therefrom the unit value of those raised breeding herd animals involved in inventory for the first time in such years and not sold, and the increase in the unit value of those raised breeding herd animals in inventory from previous years and not sold during such years.

3. That Plaintiffs are entitled to use zero as the basis of breeding animals sold during such years rather than the accrued unit value assigned to such animals in determining the amount of gain under the provisions of Section 1231 of the Internal Revenue Code of 1954.

4. That the correction of the error cause by the invalid Treasury Regulation does not constitute a change of accounting method, and therefore, Plaintiffs were not, and are not, required to obtain the consent of the Commissioner.

5. That even if a change of accounting method is involved, the law does not require a taxpayer to do a useless thing by applying to the Commissioner to change an item when the Commissioner arbitrarily refuses to consider and act upon such applications.

6. That the decision of the United States Court of Appeals for the Fifth Circuit in the case of *Scofield* v. *Lewis*, 251 F.2d 128, holding the Regulation in question invalid is controlling in this case.

(17) All findings of facts deemed conclusions of law are hereby adopted as conclusions of law.

[fol. 46] CONCLUSIONS OF LAW

From the foregoing facts the Court concludes as follows:

(1) This Court has jurisdiction of the subject matter of this action and the parties.

(2) In filing their Federal income tax returns for the years here involved, Plaintiffs erroneously, but in compliance with the provisions of Treasury Regulation Section 1.471-6(f), included within their inventory of livestock raised breeding animals which constituted a part of the breeding herd and which were held for breeding purposes. *Scofield* v. *Lewis*, 251 F.2d 128, affirming the decision of the United States District Court, Western District of Texas, 57-1 U.S.T.C. par. 9251.

(3) Section 1231 of the Internal Revenue Code clearly and unequivocally states that livestock held for breed-

ing purposes is property used in the trade or business of the taxpayer. As to such livestock, the taxpayers were not required to include them in inventory, or to use a unit-livestock-price method to determine the cost basis of animals sold. *Scofield* v. *Lewis supra*, at page 132.

(4) Treasury Regulation 1.471-6(f), and specifically the portion thereof requiring the inclusion of breeding herd animals in a ranchman's inventory, is violative of, and is in conflict with Section 1231 of the Internal Revenue Code and is therefore, invalid; consequently, the Plaintiffs should not have been compelled to include their raised breeding herd animals in inventory. *Scofield* v. *Lewis*, supra.

[fol. 47] (5) The so-called rule that re-enactment of a statute gives the force of law to a prior regulation interpreting the statute is not applicable in this case (a) because the Defendant has failed to establish that Congress had general or specific knowledge of the portion of the regulations in question;[6] (b) because the portion of the regulations in question was not in fact a construction or interpretation of the statute but was an invalid provision in conflict with that statute, and (c) because the statute in question is clear and unequivocal and therefore the rule of re-enactment is not pertinent.[7]

(6) Plaintiffs are entitled to remove from inventory raised breeding animals included in inventory in compliance with the said Treasury Regulation in the manner claimed in order to correct an error caused by the Regulation. *Scofield* v. *Lewis*, supra.

(7) Plaintiffs are entitled to use zero as the basis of breeding animals sold during the years involved herein rather than the accrued unit values assigned to such animals in determining the amount of gain under the provisions of Section 1231 of the Internal Revenue Code 1954. *Scofield* v. *Lewis*, supra.

---

[6] See Mertens Law of Federal Income Taxation, Vol. 1, Sec. 3.24 Pages 49 and 51.

[7] See Mertens. supra, at page 48, where it is stated that "The doctrine (of statutory re-enactment) has no application where the law itself is plain and needs no administrative construction. . ."

(8) Section 446(e) of the Internal Revenue Code of 1954 and the Regulations applicable thereto, requiring the consent of the Commissioner of Internal Revenue to any change in accounting method have no application to a situation where a taxpayer seeks to remove from inven-[fol. 48] tory items which, under the statute, qualify as property used in the trade or business, and which were improperly required by an invalid regulation to be included in inventory in the first place. Inasmuch as this removal does not involve a change of accounting method, neither the approval nor the consent of the Commissioner is required. In this situation, methods of accounting are not determinative of the tax liability, and for this reason neither approval nor consent of the Commissioner is required. *Scofield* v. *Lewis*, supra.

(9) The decision of the United States Court of Appeals for the Fifth Circuit in *Scofield* v. *Lewis*, supra is controlling here.

(10) Plaintiffs' selection of the accrual (inventory) method of accounting and the unit-livestock-price method of valuing inventory when they commenced operating the ranches as a partnership in 1938 was not a meaningful choice, as at that time the statute did not authorize capital gains treatment on livestock used for draft, dairy or breeding purposes. It was not until 1951 that Congress specifically authorized capital gains treatment on livestock by amending Section 117(j) of the 1939 Code; and it was not until January 20, 1958 that the Court of Appeals for the Fifth Circuit decided the case of *Scofield* v. *Lewis*, supra. Thus, in any event, Plaintiffs did not have a knowledgeable choice as to accounting methods when they began operating their ranches as sole proprietorships, or when they filed their income tax returns for 1954 and 1955, and they have validly and timely corrected the error in their inventory practices resulting from the invalid regulation.

[fol. 49] (11) Any conclusion of law deemed a conclusion of fact is hereby adopted as a finding of fact.

(12) Judgment shall be entered for the Plaintiffs for the amounts stipulated to be in controversy, together with costs.

Dated at San Antonio, Texas the 30th day of September, 1963.

/s/ ADRIAN A. SPEARS
/s/ ADRIAN A. SPEARS
United States District Judge

[fol. 50]

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

CIVIL ACTION

No. 3060

JOHN CATTO, JR. and ROXANA CATTO, his wife

v.

UNITED STATES OF AMERICA

JUDGMENT—October 15, 1963

The above entitled action having come on regularly for trial in the United States District Court at San Antonio, Texas, on the 3rd day of May, 1963, upon an agreed stipulation of facts, and the Court having heard the argument of counsel, and considered the briefs of counsel, and the Court having heretofore made and entered its findings of fact and conclusions of law, and the Court being otherwise fully advised in the premises, and for good cause shown, now, therefore, it is hereby

ORDERED, ADJUDGED and DECREED that the Plaintiffs have and recover from the Defendant the sum of TWO THOUSAND ONE HUNDRED EIGHTEEN AND 50/100 DOLLARS ($2,118.50), with interest thereon at six per cent (6%) per annum from April 15, 1955,

to a date not more than thirty (30) days from the date of payment, and the sum of FOURTEEN THOUSAND ONE HUNDRED FORTY-TWO AND 39/100 DOLLARS ($14,142.39) with interest thereon at six per cent (6%) per annum from April 15, 1956, to a date not more than [fol. 51] thirty (30) days from the date of payment, together with the costs of this action to be taxed by the Clerk of this Court.

SIGNED AND ENTERED this the 15th day of October, A.D. 1963.

/s/ ADRIAN A. SPEARS
/s/ ADRIAN A. SPEARS
United States District Judge

[fol. 52]

* * * *

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

CIVIL ACTION

No. 3060.

JOHN CATTO, JR. AND ROXANA CATTO, his wife, PLAINTIFFS

vs.

UNITED STATES OF AMERICA, DEFENDANT

NOTICE OF APPEAL

Notice is hereby given that the defendant herein hereby appeals to the United States Court of Appeals for the Fifth Circuit from the final judgment entered in this action on the 15th day of October, 1963.

ERNEST MORGAN
United States Attorney

By: /s/ HARRY LEE HUDSPETH
Assistant U. S. Attorney
Post Office Box 1701
San Antonio, Texas

CERTIFICATE OF SERVICE BY MAIL

This is to certify that a copy of the foregoing Notice of Appeal has been served on opposing counsel by depositing a copy of same in the United States Mails, postage prepaid, addressed to Mr. Gordon G. Hawn, Attorney at Law, 18th Floor Milam Building, San Antonio, Texas, on this, the 12th day of December, 1963.

/s/ HARRY LEE HUDSPETH
Assistant U. S. Attorney

[fol. 53] * * *

[fol. 54]

IN UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MINUTE ENTRY OF ARGUMENT AND SUBMISSION—
December 7, 1964

[Omitted in Printing]

[fol. 55]

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 21351

UNITED STATES OF AMERICA, APPELLANT

versus

JOHN CATTO, JR., and ROXANA CATTO, his wife, APPELLEES

Appeal from the United States District Court for the Western District of Texas.

OPINION—April 8, 1965.

Before GEWIN and BELL, Circuit Judges, and McRAE, District Judge.

PER CURIAM: This appeal raises once again the problem of the tax and accounting treatment to be accorded raised breeding cattle which are sold by an accrual basis taxpayer.[1] The appellees, who are owners [fol. 56] and operators of two cattle ranches in West Texas, keep their books on the accrual basis and file their tax returns accordingly.

Taxpayers, in conformity with Treasury regulations,[2] have chosen to value their inventory by the unit-livestock-price method. If this method is used, standard unit values are assigned to different classes of animals within the herd, representing estimated rather than actual expenses of raising each animal, and standard increments

[1] The identical issue is raised in United States v. Wardlaw, No. 21607, ... F.2d ....., decided this day.

[2] Treas. Reg. 1.471-6(c).

are added to closing inventory each year. Under Treas. Reg. 1.471-6(f), a taxpayer who elects to use the unit-livestock-price method of valuing his inventory must apply it to all of his *raised* livestock, whether they are held for sale or for breeding purposes. Hence, an accrual taxpayer who employs the unit-livestock-price method must include his raised breeding cattle in inventory along with his cattle held for sale, although the breeding cattle may be taxed at capital gains rates upon sale.[3]

Prior to and during the taxable years in question, the taxpayers complied with Treas. Reg. 1.471-6(f). They removed the raised breeding cattle which they sold from opening and closing inventory for the year of sale and paid a capital gains tax on the sales, using the inventory value under the unit-livestock-price method as the basis for computing the gain on the sale of each animal.

Taxpayers then instituted this suit for refund in the district court, contending, on the basis of our decision [fol. 57] in *Scofield* v. *Lewis*, (5 Cir. 1958) 251 F.2d 128, that Treas. Reg. 1.471-6(f) is invalid and that they may therefore correct the erroneous inclusion of raised breeding cattle in inventory by removing all such cattle from closing inventory. This procedure, in effect, affords them a deduction of the estimated raising costs against ordinary income, but they must compute the gain on the sale of these cattle on a zero basis. The net effect of this transaction is to substitute a deduction against ordinary income for a deduction against capital gains. The district court, following *Scofield*, ruled in favor of the taxpayers.

The Government challenges the propriety of applying the *Scofield* rationale, urging that the requirement that raised breeding cattle be inventoried is merely a convenient means of capitalizing the cost of such cattle until the time of sale and, as such, is a valid exercise of the Commissioner's power to prescribe accounting methods which accurately reflect income. The taxpayers, on the other hand, note the discriminatory effect of this requirement on accrual taxpayers, since the Treasury has long indulged similar cash basis taxpayers by allowing them to write off the raising costs of breeding cattle against

[3] 26 U.S.C.A. § 1231(b)(3).

ordinary income and compute their capital gain on the sale of such cattle on a zero basis. They argue that *Scofield* was correct in holding that Treas. Reg. 1.471-6 (f) is inconsistent with section 1231(b)(3), which accords all breeding cattle capital gains treatment. While we are fully cognizant of the anomaly of allowing such tax treatment of a capital asset and appreciate the appealing con- [fol. 58] ceptual arguments of the Government, we regard *Scofield* as controlling until its legislative or judicial demise.[4]

Since *Scofield* governs on the issue of the invalidity of Treas. Reg. 1.471-6(f), we think the taxpayer is justified in correcting the error which the regulation imposed by the procedure which he suggests, even though it results in an inordinate deduction against ordinary income in the year in which the correction is made. Moreover, we do not deem this a change in accounting method which necessitates the consent of the Commissioner, particularly in view of the consistent refusal of the Commissioner, during the years in question, to entertain applications by accrual basis cattle ranchers to change to the cash method of accounting for tax purposes.[5]

Accordingly, the judgment is AFFIRMED

---

[4] We are also aware of the fact that the two Circuits that have examined the problem since the *Scofield* decision have refused to follow it, see Little v. Commissioner (9 Cir. 1961) 294 F.2d 661; United States v. Ekberg (8 Cir. 1961) 291 F.2d 913, *cert. denied*, 368 U.S. 920, 7 L.Ed.2d 135, and that this Court has severely limited its applicability, see Carter v. Commissioner (5 Cir. 1958) 257 F.2d 595, which relates to purchased breeding animals inventoried on the farm-price method.

[5] It was stipulated that during the years 1954-1958, the Commissioner refused to consider ranchers' requests to change from accrual accounting methods to the cash receipts and disbursements method. A similar situation obtained during the years 1946-1949, as indicated by *Scofield* v. *Lewis*, 251 F.2d at 131. The taxpayer, therefore, feels he cannot escape from the "Box" in which his election has placed him.

[fol. 59]

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1964

No. 21351

D. C. Docket No. C. A. 3060

UNITED STATES OF AMERICA, APPELLANT

versus

JOHN CATTO, JR., AND ROXANA CATTO, HIS WIFE, APPELLEES

Appeal from the United States District Court for the Western District of Texas.

Before GEWIN and BELL, Circuit Judges, and M RAE, District Judge.

JUDGMENT—April 8, 1965

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

Issued as Mandate: May 3, 1965

[fol. 60]

[Clerk's Certificate to foregoing transcript omitted in printing]

[fol. A] [File Endorsement Omitted]

[fols. 1-2] * * *

[fol. 3]

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
DEL RIO DIVISION

CIVIL ACTION
No. 306

W. H. WARDLAW, independent Executor of the Estate of C. W. Wardlaw, Deceased, et al
vs.
UNITED STATES OF AMERICA

CIVIL ACTION
No. 307

W. H. WARDLAW and wife, MATTYE GWEN WARDLAW
vs.
UNITED STATES OF AMERICA

CIVIL ACTION
No. 328

W. R. WHITEHEAD and wife, DORA WHITEHEAD
vs.
UNITED STATES OF AMERICA

CIVIL ACTION
No. 329

F. H. WHITEHEAD and wife, WINNIE WHITEHEAD
vs.
UNITED STATES OF AMERICA

CIVIL ACTION
No. 330

L. D. WHITEHEAD
vs.
UNITED STATES OF AMERICA

CIVIL ACTION

No. 331

F. J. BARRETT and wife, ALMA BARRETT

vs.

UNITED STATES OF AMERICA

[fol. 4]

CIVIL ACTION

No. 332

R. W. HODGE, and wife, ANALE HODGE

vs.

UNITED STATES OF AMERICA

CIVIL ACTION

No. 333

B. E. WILSON and wife, ELSIE WILSON

vs.

UNITED STATES OF AMERICA

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above entitled actions were brought by Plaintiffs against Defendant for the recovery of income taxes and interest thereon heretofore assessed against and collected from Plaintiffs, respectively, by Defendant. After Defendant answered in each of such causes, all of the issues involved therein with respect to the determination of Plaintiffs' inventory of livestock and the calculation of gain upon the sale of livestock held for breeding purposes were upon motion of Plaintiffs and by order of this Court, severed from the other issues involved in such actions for trial separately by the Court without a jury. Plaintiffs, respectively, and Defendant having made and entered into stipulations of fact, Plaintiffs filed their respective Motions for Summary Judgment with relative to raised animals held for breeding, purposes, and with respect to purchased animals held for breeding purposes. Defendant also filed its Motions for Summary Judgment.

There being no dispute as to any material fact, and these suits involving common question of law, the above entitled actions were consolidated for purposes of briefing, argument and trial and came on for trial jointly in the United [fol. 5] States District Court for the Western District of Texas, Del Rio Division, sitting in San Antonio, Texas, on the 3rd day of May, 1963, for oral argument and submission, and the Court having considered the Stipulations of Facts entered into between Plaintiffs and Defendant, the briefs submitted by the parties in support of their respective Motions for Summary Judgment, and the arguments of counsel, upon the entire record, now makes the following findings of fact and conclusions of law:

Findings of Facts

(1) These suits are for the recovery of income taxes and interest heretofore assessed against and collected from Plaintiffs by Defendant and are brought pursuant to the provisions of Sec. 1346(a)(1) of Title 28 of the United States Code Act of June 25, 1948, Chapter 646, 62 Stat. 869, as amended by Act of July 30, 1954, Chapter 648, Sec. 1, 68 Stat. 589.

(2) Each of these cases raises the following questions:

1. With regard to raised breeding animals:

   (a) Whether that portion of Regulation 1.471-6 (f) which requires the inclusion of raised livestock held and used by Plaintiffs for breeding purposes in their inventory of livestock and the valuation thereof under the unit-livestock-price method is in conflict with or restrictive of the provisions of Section 1231 of the Internal Revenue Code, and therefore invalid.

[fol. 6] (b) Whether the Plaintiffs are required to obtain the Commissioner's consent, in accordance with Section 446(e) of the Internal Revenue Code, to remove from inventory breeding animals which under Sec. 2131 of the Internal Revenue Code qualify as property used in trade or business and which were required by Regulation

1.471-6(f) to be included in inventory in the first place.

(c) Whether the cost basis to be used in computing capital gain on the sale of raised breeding animals sold is zero.

2. With regard to purchased breeding animals:

(a) Whether animals purchased for draft or breeding purposes after animals previously purchased had been included in inventory, may be treated as capital assets subject to depreciation after maturity during the years in question.

(b) Whether the cost basis to be used in computing the capital gain on the sale of purchased breeding livestock sold is the cost thereof less depreciation.

(3) All the material facts herein have been stipulated and the Stipulation of Facts entered into between Plaintiffs, respectively, and Defendant are hereby found as stipulated and incorporated herein.

(4) Plaintiffs have been engaged in the business of ranching in the capacities and from the times set opposite their names below and were so engaged during the years here involved, also set opposite their names below:

[fol. 7]

Civil Action	Plaintiffs	Capacity	Dates of Commencement of Ranching Business	Years Involved
306	C. W. WARDLAW, now deceased, (W. H. Wardlaw, Executor)			
307	and W. H. WARDLAW	Partnership	1935	1955-1959
328	W. R. WHITEHEAD	Sole Proprietorship	1927	1957-1959
329	F. H. WHITEHEAD	Sole Proprietorship	1927	1957-1959
330	L. D. WHITEHEAD	Sole Proprietorship	1927	1957-1959
331	F. J. BARRETT	Sole Proprietorship	1917	1958-1959
332	W. R. HODGE	Sole Proprietorship	1941	1958-1959
333	B. E. WILSON	Sole Proprietorship	Prior to 1913	1958-1959
		and Partnership	1948	1958-1959

[fol. 8] (5) The ranching businesses conducted by Plaintiffs since the time of commencement thereof and during the years here involved, as above stated, consisted of breeding and raising sheep, goats and cattle principally for the production of wool, mohair, mutton and calves. Plaintiffs maintained breeding herds of sheep, goats and cattle for use in connection with their ranching businesses. As circumstances required, Plaintiffs purchased bucks, ewes, billies, nannies, bulls and cows for addition to their breeding herd to increase their herds, improve the quality and prevent inbreeding. Also, as circumstances required, Plaintiffs selected certain lambs, kids and cows produced from the breeding herd and added same to the breeding herd. The number of animals to be retained in the breeding herd was determined on the basis of range conditions, rainfall, cost of operation and other factors. When required by age, disease, or other circumstances, Plaintiffs culled from their breeding herd certain animals which were held for breeding purposes but which were unfit for breeding stock or which for some other reason could not be retained and same were sold. Lambs, kids and calves produced by the breeding herd and not added to the breeding herd, as well as wool and mohair produced by the breeding herd were sold in due course of business. Plaintiffs also maintained a herd of stallions, mares and saddle horses which were used in conducting their ranching business.

(6) Each of Plaintiffs had the right to select his method of accounting *when he commenced business*, and each Plaintiff did select the accrual inventory method of accounting at that time. However, such selection as to raised animals was not a meaningful free choice, or, as [fol. 9] the Defendant puts it, not an "enlightened free choice," because the selection was made prior to the time that it had become clear, under applicable statutes, regulations and litigated cases, that the selection of one method of accounting would produce capital gains on the appreciation in value of raised breeding animals and the selection of another method would produce ordinary income. The first possible time that Plaintiffs could have had full and complete knowledge of their right to make a choice as to accounting methods would have been for the taxable

year 1957, which was after the decision in *Scofield* v. *Lewis* was rendered on January 20, 1958, and they have made their election as to 1957, and all subsequent years, within the time allowed them by the three year statute of limitations in the tax laws.

(7) In 1942, Section 117(j), which provided for capital gains treatment for "property used in the trade or business," was added to the Internal Revenue Code of 1939 by Section 151(b) of the Revenue Act of 1942. There was nothing in the Internal Revenue Code of 1939 as originally enacted, nor in any prior Revenue Act, relating to property used in the trade or business, corresponding to Section 117(j). In 1951, Section 117(j) of the Internal Revenue Code of 1939 was amended by Section 324 of the Revenue Act of 1951 to provide specifically that the term "property used in the trade or business * * * includes livestock, regardless of age, held by the taxpayer for draft, breeding or dairy purposes * * *." Thereafter, Section 117(j) of the Internal Revenue Code, as amended by the Revenue Act of 1951, was re-enacted, without any consequential change, as Section 1231 of the [fol. 10] Internal Revenue Code of 1954, the language of which is clear and unequivocal and the intent of which is plain.

(8) From the time they commenced business, as above stated, until 1944, Plaintiffs each valued their livestock inventories under the "constant unit-price" method. In December, 1944, Regulation 111, Sec. 29.22(c)-6 was amended by TD 5423, 1945 CB 70, to provide that:

> "A livestock raiser who had for taxable years beginning prior to January 1, 1944, adopted a constant unit-price method of valuing livestock inventories and filed returns on that basis will be considered as having elected the 'unit-livestock-price method'."

Therefore, Plaintiffs were in 1944 required by the Commissioner's Regulation to follow the "unit-livestock-price-method" of valuing inventories.[1]

---

[1] Regulation 111, Sec. 29.22(c)-6, as amended by TD 5423, was succeeded by Regulation 118, Sec. 39.22(c)-6 and Regulation 1.471-6,

(9) T.D. 5423, supra, further amended Regulation 111, Sec. 29.22(c)-6, to provide that:

> "A taxpayer who elects to use the 'unit-livestock-price method' must apply it to all livestock raised, whether for sale or for breeding, draft or dairy purposes."

Therefore, Plaintiffs, in 1944, were also required by the Commissioner's Regulation to include their raised breeding animals in their livestock inventories along with animals raised and held for sale on the market.

[fol. 11] (10) During the years here involved each of the Plaintiffs, except Plaintiffs B. E. WILSON, R. W. HODGE and F. J. BARRETT, as required by the Commissioner's Regulations, included their raised breeding animals in their inventory along with animals raised and held for sale on the market and valued such raised breeding animals under the unit-livestock-price method pursuant to and in accordance with the Regulations. Plaintiffs B. E. WILSON, R. W. HODGE and F. J. BARRETT did not include their raised breeding animals in their inventories in the years 1957, 1958 and 1959.[2]

(11) As a result of the foregoing requirements of the Regulations that these Plaintiffs use the unit-livestock-price method and include raised breeding animals in inventory, the initial inventory value of raised breeding animals put in inventory was taxed as ordinary income, and all annual increases thereafter in the inventory value of such raised breeding animals were also taxed as ordinary income.

(12) Although Treasury Regulation 1.471-6(g), and its predecessors, did not require the taxpayers to do so, they voluntarily elected to include their purchased breeding animals in inventory, rather than capitalize them, for each year beginning with the inception of their busi-

---

which contained the same language set forth in the original Treasury Decision amending the Regulation with the exception of minor changes of detail.

[2] Upon audit of their income tax returns, the Commissioner of Internal Revenue required these Plaintiffs to include the raised breeding animals in their livestock inventory in each of such years.

nesses up to 1957, and the Commissioner of Internal Revenue has not consented for taxpayers to treat such purchased breeding animals as a capital asset in the years 1957, 1958 and 1959.

[fol. 12] (13) In each of the years here involved, as well as in the previous years, Plaintiffs culled and sold from their breeding herd some of their breeding animals (including both raised and purchased animals) which had been held and used by them for breeding purposes for more than twelve months before the date of such sales, but which were unfit for breeding purposes or which for other reasons were not suitable or desirable for retention in their breeding herds. Plaintiffs reported the gain on the sale of raised breeding animals as gain on the sale of capital assets and calculated such gain by using the accrued unit inventory value assigned to such animals as the basis. Also, in connection with their purchased breeding animals, Plaintiffs reported their gains on the sale of purchased breeding animals as gain on the sale of capital assets, and calculated such gain by using the cost thereof, less the depreciation claimed, as the basis for such animals sold.

(14) Plaintiffs' Federal income tax returns for each of the years here involved, which were timely filed and which reflected the foregoing, were audited by the Commissioner of Internal Revenue. In connection with such audit, Plaintiffs claimed in their protest filed with the Commissioner that Plaintiffs had erroneously included their raised breeding animals in inventory and had erroneously calculated gain on the sale of such raised breeding animals by using the accrued inventory value as the basis. Plaintiffs claimed that they were not required to include raised breeding animals in inventory and that they were not required to use the inventory value as the basis in computing gain on the sale of raised breeding animals, but should, instead, use a basis of zero in cal-

[fol. 13] culating the gain on the sale of raised breeding animals. Plaintiffs claims in this regard were based on the decision of the United States Court of Appeals, Fifth Circuit, in the case of *Scofield* v. *Lewis*, 251 F.2d 128, which declared that the Commissioner's Regulation re-

quiring taxpayers to include raised breeding animals in inventory were invalid. These claims were denied by the Commissioner. In addition, the Commissioner denied and disallowed the deduction claimed by Plaintiffs for depreciation with respect to purchased breeding animals. Furthermore, the Commissioner required Plaintiffs to include the breeding animals purchased in each of the years here involved in Plaintiffs' livestock inventories without any allowance for depreciation, exhaustion, wear and tear, and required Plaintiffs to use the inventory value (i.e., cost, without any allowance for depreciation) of purchased breeding animals as the basis for the calculation of gain upon the sale thereof.

(15) After paying the difference in tax claimed by the Commissioner, Plaintiffs filed timely claims for refund, based on removing raised breeding animals from closing inventory and capitalizing breeding animals purchased in 1957, 1958 and 1959, and reporting the gain on all breeding animals sold during the years in question as capital gains, using zero as the basis for raised breeding animals and using the depreciation cost as the basis for purchased breeding animals. In the computation of their claim for refund Plaintiffs also determined a reasonable allowance for depreciation on breeding animals purchased in 1957, 1958 and 1959 and deducted such in determining the amount of the refund. These claims [fol. 14] for refund were rejected, and these suits were filed in the United States District Court, Western District of Texas.

(16) In their claims for refund, in these suits, and in their motions for summary judgment, Plaintiffs claim, as to raised breeding animals, that the portion of Regulation 1.471-6, and its predecessors, by which Plaintiffs were required to include raised livestock held for breeding purposes in inventory, was and is invalid because it is in conflict with Section 1231 of the Internal Revenue Code which provides that livestock held for draft or breeding purposes constitute "property used in the trade or business" and that gains on the sale of "property used in the trade or business" shall be considered as gains from the sale of capital assets; since the raised breeding

animals were erroneously required to be included in inventory pursuant to the Regulation, Plaintiffs are entitled to remove such raised breeding animals from their closing inventory; and, properly computed, capital gain on the sale of raised livestock held for breeding purposes is the excess of proceeds from the sale over zero. As to purchased breeding animals, Plaintiffs claim that, since they did not elect to include breeding animals purchased in 1957, 1958 and 1959 in inventory, as permitted, but not required, by Regulation 1.471-6(f), they are entitled to a reasonable allowance for depreciation with respect to breeding animals purchased in 1957, 1958 and 1959 because such animals constitute property used in the trade or business, and are of a character subject to the allowance for depreciation provided in Section 167 of the Internal Revenue Code.

[fol. 15] (17) It is found as a fact that when Section 117(j) of the Internal Revenue Code of 1939, as amended by the Revenue Act of 1951, was re-enacted as Section 1231 of the Internal Revenue Code of 1954, Congress had no general or specific knowledge of the portion of the regulations in question requiring that taxpayers who used the unit-livestock-price method must include their raised breeding animals in inventory along with raised animals held for sale in the ordinary course of business.

(18) In view of the length and complexity of the Code itself, and the extreme length and complexity of the Regulations, it would be unreasonable to conclude that Congress had even a general knowledge of the full import of the Regulations. The letter of June 27, 1952, from the Secretary of the Treasury to the Chairman of the Senate Finance Committee, which the Defendant describes as apprising Congress in most thorough and clear terms of the existing law as understood and administered regarding livestock held for breeding purposes, fails to mention or make reference to the fact that the Commissioner, by his Regulations, required taxpayers who used the unit-livestock-price method to include their raised breeding animals in inventory along with raised animals held for sale in the ordinary course of business. This letter did not constitute notice to Congress of the regulation in question.

(19) The Commissioner of Internal Revenue did not consider requests filed by ranchers to change their method of accounting for Federal income tax purposes from the accrual-inventory method to the cash receipts and disbursements method until the final regulations under [fol. 16] Section 481 of the Internal Revenue Code of 1954 were issued, same having been issued on February 19, 1959.

Conclusions of Law

(1) This Court has jurisdiction of these actions pursuant to the provisions of Section 1346(a)(1) of Title 28 United States Code, Act of July 25, 1948, C. 646, 62 Stat. 869, as amended by Act of July 30, 1954, C. 648, Sec. 1, 68 Stat. 589.

(2) Regulation 1.471.6(f), and specifically the portion thereof requiring the inclusion of breeding herd animals in a ranchman's inventory, is violative of, and is in conflict with, Section 1231 of the Internal Revenue Code and is, therefore, invalid; consequently, the Plaintiffs should not have been compelled to include their raised breeding herd animals in inventory. *Scofield* v. *Lewis*, 251 F.2d 128, affirming the decision of the United States District Court, Western District of Texas, 57-1 USTC, Paragraph 9251.

(3) Section 446(e) of the Internal Revenue Code, and the Regulations applicable thereto, requiring the consent of the Commissioner of Internal Revenue to any change in accounting method have no application to a situation where a taxpayer, within the three year statute of limitations after being charged with full knowledge of his right to correct the error in his inventory practices resulting from the invalid regulation referred to in the preceding paragraph, seeks to remove from inventory raised breeding animals which, under the statute, qualify as property used in the trade or business, and which were improperly required by such invalid reg- [fol. 17] ulation to be included in inventory in the first place. Inasmuch as this removal does not involve a change of accounting method, neither the approval nor the consent of the Commissioner is required. In this situation,

methods of accounting are not determinative of the tax liability, and for this reason neither approval nor consent of the Commissioner is required. See *Scofield* v. *Lewis*, supra, at page 132.

(4) Section 1231 of the Internal Revenue Code clearly and unequivocally states that livestock held for breeding purposes is property used in the trade or business of the taxpayer. As to such livestock, the taxpayers were not required to include them in an inventory, or to use a unit-livestock-price method to determine the cost basis of animals sold. *Scofield* v. *Lewis*, supra, at page 132.

(5) The so-called rule that re-enactment of a statute gives the force of law to a prior regulation interpreting the statute is not applicable in this case (a) because it has been found as a fact that Congress had no general or specific knowledge of the portion of the regulations in question [1], (b) because the portion of the regulations in question was not in fact a construction or interpretation of the statute but was an invalid provision in conflict with the statute, and (c) because the statute in question is clear and unequivocal and therefore the rule of re-enactment is not pertinent.[2]

[fol. 18] (6) Plaintiffs are entitled to remove from closing inventory, for each of the years involved, all raised breeding animals. As to raised breeding animals sold during the years in question, Plaintiffs shall compute capital gain on a basis of zero rather than inventory values.

(7) Plaintiffs' selection of the accrual (inventory) method of accounting and the unit-livestock-price method of valuing inventory when they commenced operating their ranches was not a meaningful choice, as the statute then did not authorize capital gains treatment in livestock used for draft, dairy or breeding purposes. It was not until 1951 that Congress authorized capital gains treatment on livestock by amending Section 117(j) of the

---

[1] See *Mertens Law of Federal Income Taxation*, Vol. 1, Sec. 3.24, Pagges 49 and 51.

[2] See *Mertens*, supra, at page 48, where it is stated that "The doctrine (of statutory re-enactment) has no application where the law itself is plain and needs no administrative construction . . .".

1939 Code, and it was not until January 20, 1958, that the Court of Appeals for the Fifth Circuit decided the case of *Scofield* v. *Lewis*, supra. Thus, in any event, the first time that Plaintiffs could have had the kind of full and complete knowledge necessary to an enlightened and meaningful free choice as to their right to correct the error in their inventory practices resulting from the invalid regulation referred to in paragraph (2) of these conclusions of law, would have been with respect to the taxable year 1957. Plaintiffs, since filing their 1957 tax return have validly made their election as to 1957, and it was timely accomplished within the period allowed them by the three year statute of limitations in the tax laws.

(8) Since Plaintiffs B. E. WILSON, R. W. HODGE and F. J. BARRETT did not include their raised breeding animals in their inventories in the year 1957, 1958 and 1959, they clearly made a valid election with respect to [fol. 19] the taxable year 1957, as to the accounting method they desired to use, and any subsequent change therein would have required the consent of the Commissioner.

(9) The holding of the Court of Appeals for the Fifth Circuit in *Scofield* v. *Lewis*, supra, that the Treasury Regulation in question is invalid as to raised breeding animals, is controlling as to the raised breeding animals involved in this case.

(10) Having for each year, from the inception of their businesses up to 1957, voluntarily elected to include purchased breeding animals in inventory, without having been required by the Treasury Regulations to do so, the taxpayers are bound by that election for 1957, 1958 and 1959, as well as for future years, with respect to all purchased breeding animals, unless they obtain the Commissioner's consent to change. Revenue Ruling 60-60, 1960-1, Cum. Bull 190; Cf. *Carter* v. *Commissioner*, 257 F.2d 595, (5 Cir. 1958).

(11) Plaintiffs' Motions for Summary Judgment with respect to raised animals held for breeding purposes should be granted, but insofar as they relate to purchased animals held for breeding purposes they should be denied.

(12) Defendant's Motions for Partial Summary Judgment with respect to raised animals held for breeding purposes should be denied, but insofar as they relate to purchased animals held for breeding purposes they should be granted.

[fol. 20] (13) Judgment will be entered in accordance with these findings of fact and conclusions of law.

Dated at San Antonio, Texas, this 30th day of September, 1963.

/s/ ADRIAN A. SPEARS
/s/ ADRIAN A. SPEARS
United States District Judge

* * * *

[fols. 21-64] * * *

[fol. 65]

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
DEL RIO DIVISION

CIVIL ACTION
No. 307

W. H. WARDLAW and wife, MATTYE GWEN WARDLAW,
PLAINTIFFS

vs.

UNITED STATES OF AMERICA, DEFENDANT

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between Plaintiffs and Defendant, by their respective attorneys of record, that the following facts may be taken as true without the necessity of either party hereto introducing evidence in support thereof other than this Stipulation, but this shall not prevent either party hereto from introducing upon the trial of this case such further evidence not inconsistent with the facts herein stipulated to be true as such party see fit:

1. Plaintiffs W. H. WARDLAW and MATTYE GWEN WARDLAW are husband and wife and are citizens of the State of Texas and at all material times herein resided in Val Verde County, Texas, and are legal residents within the Western District of Texas, Del Rio Division of the United States District Court.

W. H. WARDLAW was at all material times herein a partner in Wardlaw Brothers, a copartnership composed of C. W. WARDLAW, W. H. WARDLAW and C. W. WARDLAW and W. H. WARDLAW as Trustees under the Will of CODY M. WARDLAW, Deceased, [fol. 66] said partnership being herein after referred to as the "Partnership."

2. The Partnership made, executed and duly filed within the time prescribed by law with the District Director of Internal Revenue for the First District of Texas, its

partnership income tax returns for the calendar years 1955, 1956, 1957, 1958 and 1959, respectively, copies of each of which are attached hereto marked Exhibits "A", "B", "C", "D" and "E". Plaintiffs made, executed and duly filed within the time prescribed by law with the District Director of Internal Revenue for the First District of Texas, in which District Plaintiffs resided, joint income tax returns for the calendar years 1955, 1956, 1957, 1958 and 1959, respectively, copies of each of which returns are attached hereto, marked Exhibits "F", "G", "H", "I" and "J", respectively. Plaintiffs paid the tax respectively disclosed in such returns to the District Director of Internal Revenue for the First District of Texas within the time prescribed by law.

3. The Partnership and Plaintiffs as copartners thereof. have been engaged in the business of ranching in Val Verde County, Texas, as co-partners since 1935, and were so engaged during the years 1955 through 1959, such ranching business being conducted on certain land situated in Val Verde County and Edwards County, Texas, which Plaintiffs own or lease.

4. Since 1935 and at all material times herein, the ranching business conducted by the Partnership consisted of breeding and raising sheep, goats and cattle, principally for the production of wool, mohair, mutton and calves. The Partnership maintained breeding herds of [fol. 67] sheep, goats and cattle for use in connection with their ranching business. As circumstances required, the Partnership purchased bucks, ewes, billies, nannies, bulls and cows for addition to their breeding herd to increase their herds, improve the quality and prevent inbreeding. Also, as circumstances required, the Partnership selected certain lambs, kids and calves produced from the breeding herd and added same to the breeding herd. The number of animals to be retained in the breeding herds were determined on the basis of range conditions, rainfall, cost of operation and other factors. When required by age, disease or other circumstances, the Partnership culled from their breeding herd animals which were sold for breeding purposes but which were unfit for breeding stock or which for some other reason could not be retained

and same were sold. Lambs, kid and calves produced by the breeding herd and not added to the breeding herd were sold in the due course of business.

5. When the Partnership commenced its ranching business in 1935, Plaintiffs selected the inventory (accrual) method of accounting. From 1935 until the effective date of Regulation 111, Sec. 29.22(c)-6, as amended by TD 5423, December 15, 1944, 1945 CB-70, Plaintiffs carried all of their livestock on an inventory basis, and valued such livestock inventories under the constant price method. In each year, from the effective date of Regulation 111, Sec. 29.22(c)-6, as amended by TD 5423, supra, (i.e., including and after the taxable year 1944 and thereafter) and at all material times thereafter, the Partnership was required by the Regulations next below mentioned to and did carry all their livestock raised and held for sale on the market, and also their raised and [fol. 68] purchased livestock[1] constituting their breeding herd and held by them for breeding purposes, on an inventory basis valuing all purchased livestock at cost, and all raised livestock under the unit livestock price method pursuant to and in accordance with Treasury Regulation 111, Sec. 29.22(c)-6 as amended by TD 5423, 1945 CB-70, and its successor, Regulation 118, Sec. 39.22(c)-6, and Regulation 1.471-6, as applicable, same being hereinafter referred to as "the Regulations."

6. As the first step in determining their "Net Profit" from their ranching business for income tax purposes in their income tax returns for 1955, 1956, 1957, 1858 and 1959, the Partnership deducted from their "Gross Sales" of livestock and livestock products the "Cost of (such) Goods Sold" to arrive at their "Gross Profit."

7. In determining their "Costs of Goods Sold" with respect to their ranching business, (as a part of the determination of Gross Profit), the Partnership determined

---

[1] The Partnership did not include breeding herd animals purchased in 1957, 1958 and 1959 in the inventories of livestock as reported in their income tax returns; however, the Commissioner of Internal Revenue, upon audit of the Partnership income tax returns for 1957, 1958 and 1959 required that all such animals be included in the Partnership closing inventory for such years, as more fully appears in Paragraph 26, below.

their inventory of livestock at the beginning of the year, (herein referred to as the "Opening Inventory") valued same in compliance with the unit livestock price method, as provided in the Regulations, added thereto all animals purchased and subtracted therefrom their inventory of livestock at the end of the year (herein referred to as the "Closing Inventory") valued in compliance with the [fol. 69] unit livestock price method as provided in the Regulations, to arrive at their "Cost Of Goods Sold."

8. As the second step in determining their "Net Profit" from their ranching business for income tax purposes in their income tax returns for 1955, 1956, 1957, 1958 and 1959, the Partnership deducted from their "Gross Profit" for such year depreciation sustained with respect to property used in their trade or business and cost of labor, materials and supplies, and all other expense incurred in their trade or business to arrive at their "Net Profit" for income tax purposes.

9. The calculations described in Paragraphs 6, 7 and 8 above are summarized in columnar form as follows:

Gross Sales of Livestock and Livestock Products		00.00
(less)		
Cost of Goods Sold		
Opening Inventory	00.00	
add: Purchased Animals	00.00	
Total	00.00	
less: Closing Inventory	00.00	00.00
(equals)		
Gross Profit		00.00
Less: Depreciation	00.00	
Labor	00.00	
Materials & Supplies	00.00	00.00
Expenses	00.00	00.00
(equals)		
Net Profit		00.00

9a In applying the steps set out in Paragraph 9 above to determine "Net Profit" in this case, proceeds from the [fol. 70] sale of breeding animals were not included in "Gross Sales" and "Opening Inventory" was reduced in the year of sale of such breeding animals, by the amount of inventory value of breeding animals sold.

10. Attached hereto marked Exhibits "K", "L", "M", "N" and "O" are schedules of livestock owned by the Partnership as of December 31, 1957, 1958 and 1959, respectively, showing the following according to kind and classification thereof.

Column I: Unit livestock prices with respect to each kind and classification of livestock.

Column II: Inventory of livestock (and the unit values assigned thereto as shown in Column III) as reported by Plaintiffs in their Federal Income tax returns.

Column IV: Number of head of livestock (and the values thereof as shown in Column V) constituting the breeding herd of Plaintiffs which had been raised or purchased by them in years prior to 1955, 1956, 1957, 1958 and 1959, respectively.

Column VI: Number of head of livestock (and the values thereof as shown in Column VII) purchased by Plaintiffs and added to their breeding herd during 1955, 1956, 1957, 1958 and 1959, respectively.

Column VIII: Number of head of livestock (and the values thereof as shown in Column IX) raised by Plaintiffs and added to their

[fol. 71]

breeding herd during 1955, 1956, 1957, 1958 and 1959, respectively.

Column X: Number of head of livestock (and the values thereof as shown in Column XI) held by Plaintiffs for sale on the market.

11. In connection with the valuation of their inventory of livestock, Plaintiffs assigned to the various kinds, classifications and categories of raised animals [2] included

[2] Upon audit of the Partnership income tax for 1957, 1958 and 1959, the Commissioner of Internal Revenue required that purchased breeding animals be also included in the closing inventory for such years.

within such inventory, a unit value in accordance with the Regulations as described in Column I of Exhibits "K", "L", "M", "N" and "O" attached hereto, and as such livestock advanced in age, there was assigned to and accrued with respect to such raised livestock the respective unit values and respective advances in accordance with said Regulations.

12. The livestock described in Column X of Exhibits "K", "L", "M", "N" and "O", respectively, constituted the livestock raised and held by the Partnership for sale on the market as of December 31, 1955, 1956, 1957, 1958 and 1959, respectively.

13. The livestock described in Columns IV, VI and VIII of Exhibits "K", "L", "M", "N" and "O" attached hereto constituted the breeding herd of the Partnership and was held and used by the Partnership for breeding purposes in conducting their trade or business during 1955, 1956, 1957, 1958 and 1959, respectively, said breeding herd being comprised in the aggregate of the livestock [fol. 72] described in Column IV which had been raised or purchased by the Partnership and was held by them for breeding purposes in 1955, 1956, 1957, 1958 and 1959, respectively, and the livestock described in Column VI which was purchased by the Partnership and added to their breeding herd and held by the Partnership for breeding purposes during 1955, 1956, 1957, 1958 and 1959, respectively, and the livestock described in Column VIII, which was raised by the partnership and added to their breeding herd and held by the Partnership for breeding purposes in 1955, 1956, 1957, 1958 and 1959, respectively.

14. The livestock referred to in Paragraph 13 next above constituted "property used in the trade or business" of the Partnership as defined in Section 1231 of the Internal Revenue Code of 1954, provided that such livestock met the requisite holding period.

15. In their Partnership income tax returns for 1955, 1956, 1957, 1958 and 1959, respectively, the Partnership carried all of their livestock raised and held for sale on the market, and also their raised animals constituting their breeding herd and held and used by them for breeding purposes, on an inventory basis, as described in

Column II of Exhibits "K", "L", "M", "N" and "O", respectively, valuing such livestock inventories under the unit livestock price method as described in Column III of Exhibits "K", "L", "M", "N" and "O", respectively, in accordance with the Regulations.

(c) Each increase in the closing inventory decreased the "Cost of Goods Sold" and concurrently increased "Gross Profit" and "Net Profit."

[fol. 73] 18. During 1957, 1958 and 1959, respectively, the Partnership purchased the livestock described in Column VI of Exhibits "M", "N" and "O", respectively, for addition to their breeding herd to increase their herds and improve the quality thereof.

19. Such livestock referred to in Paragraph 18 above constituted "property used in the trade or business" of the Partnership, as defined in Section 1231 of the Internal Revenue Code, and was of a character which was subject to the allowance for depreciation provided for in Section 167 of the Internal Revenue Code, provided such livestock met the requisite holding period of Sec. 1231.

20. In their income tax returns for 1957, 1958 and 1959, the Partnership treated such animals referred to in Paragraph 18 above as property used in their trade or business, subject to depreciation and computed and deducted, in determining their net profit from their ranching business, a reasonable allowance for depreciation sustained in such years, respectively, with respect to such livestock.

21. During 1955, 1956, 1957, 1958 and 1959, respectively, the Partnership culled and sold from their breeding herd some of their sheep, goats and cattle, (including both raised and purchased animals) which had been held and used by them for breeding purposes for more than twelve months before the date of such sales but which were unfit for breeding purposes or which for other reasons were not suitable or desirable for retention in their breeding herds.

[fol. 74] 22. Such raised livestock referred to in Paragraph 21 was included in the Partnership's inventory of livestock in 1955, 1956, 1957, 1958 and 1959, respectively, and in years prior thereto, subsequent to the effective

date of the Regulations, and in such years, pursuant to the requirements of the Regulations, unit values had been assigned to such livestock as and when same were included in such inventory and the respective advances accrued with respect to such livestock as same advanced in age and classification, all in accordance with the unit livestock price method as provided in the Regulations.

23. In their income tax returns for 1957, 1958 and 1959, the Partnership, pursuant to the provisions of Section 1231 of the Internal Revenue Code, reported their gains on the sale of purchased livestock held for breeding purposes as gains on the sale of capital assets. The Partnership calculated such gains by using as the basis for such animals sold the cost thereof, less the depreciation claimed with respect thereto.

24. In their income tax returns for 1955, 1956, 1957, 1958 and 1959, the Partnership, pursuant to the provisions of Section 1231 of the Internal Revenue Code, reported their gains on the sale of raised livestock held for breeding purposes as gains on the sale of capital assets. The Partnership calculated such gains by using as the basis of such animals sold the accrued unit values assigned to such animals in the Partnership's inventory of livestock. In connection with the use of the accrued unit value assigned to such animals in the Partnership's inventory as the basis, the Partnership made an adjustment to their opening inventory to eliminate therefrom in [fol. 75] the year of such sale, the accrued unit value of such livestock sold.

25. For each of the years 1955, 1956, 1957, 1958 and 1959, as a result of the use of the accrued unit values assigned to livestock raised and held by the Partnership for breeding purposes in their livestock inventory as the basis for calculation of gain upon the sale thereof, amounts equal to the proceeds of such sales were

(a) Subjected to tax, in the year of such sale, at the rates applicable to gains on sale of long term capital assets, to the extent of the difference between the proceeds of such sale and the accrued unit value assigned to such livestock in the opening inventory in the year of sale, and

(b) Subjected to tax, in the year or years prior to such year of sale, at the rates applicable to ordinary income to the extent of the accrued unit values and advances thereof assigned to such livestock in closing inventory in such prior year or years.

26. Thereafter, the Commissioner of Internal Revenue caused the Partnership's income tax returns for 1955, 1956, 1957, 1958 and 1959 to be audited. In connection with such audits, the Partnership claimed, and so advised the Commissioner of Internal Revenue, in their Protest filed with him, that the Partnership had erroneously included their raised breeding animals in their livestock inventory, and further, that the Partnership had erroneously calculated their gains on the sale of raised breeding animals by using as the basis therefor the accrued unit values assigned to such animals in the Partnership's inventory, stating in said Protest as the reasons wherein [fol. 76] such was erroneous the same reasons subsequently stated in their claims for refund, hereinafter referred to, all of which claims of the Partnership were denied by the Commissioner. In addition thereto, the Commissioner denied and disallowed the deduction claimed in the Partnership's income tax returns for depreciation with respect to purchased animals held for breeding purposes, and the Commissioner adjusted Plaintiffs' livestock inventory to include such purchased breeding animals in Plaintiffs' inventories of livestock. As a result of such audits, the Commissioner of Internal Revenue determined a deficiency in income taxes due from Plaintiffs for each of said years, which deficiency was in part attributable to matters not presently in controversy and was in part attributable to the matters in controversy in this proceeding relating to the determination of the Partnership's inventories of livestock, and the calculation of gains upon the sale of livestock held by the Partnership for breeding purposes, and which deficiency including statutory interest thereon, was by Plaintiffs paid to the District Director of Internal Revenue for the First Collection District of Texas at Austin, Texas, within the time and in the manner required by law.

27. Thereafter, within the period within which claims for refund might be legally filed under Section 6511 of

the Internal Revenue Code, Plaintiffs presented and delivered to Robert L. Phinney, as District Director of Internal Revenue for the First District of Texas, at Austin, Texas, for transmission to the Commissioner of Internal Revenue, their claims for refund for overpayment of income taxes assessed against and paid by Plaintiffs for 1955, 1956, 1957, 1958 and 1959, copies of each of which [fol. 77] claims for refund being attached hereto marked Exhibits "P", "Q", "R", "S" and "T". Attached to each of said Claims for Refund for 1957, 1958 and 1959 is a schedule showing:

Column I: Computation of Partnership's net profits from their ranching business and Plaintiffs' taxable income and tax as reflected in Plaintiffs, income tax return for such year as reported by Plaintiffs.

Column II: Adjustments to Partnership's net profits from their ranching business and Plaintiff's taxable income as reported, made by the Commissioner of Internal Revenue acting by and through his Field Agent, upon audit of Plaintiffs' income tax return for such year.

Column III: Computation of Partnership's net profits from their ranching business and Plaintiffs' taxable income and tax as adjusted and finally determined by the Commissioner of Internal Revenue after audit.

Column IV: Adjustments and corrections to Partnership's net profits from their ranching business and Plaintiffs' taxable income and tax as determined by the Commissioner of Internal Revenue as claimed by Plaintiffs in asserting their Claim for Refund with respect to such year.

Column V: Computation of Plaintiffs' taxable income and tax as claimed by Plaintiffs in their Claim for Refund for such year.

[fol. 78] Each of such schedules attached to said Claim for Refund are incorporated herein as Exhibits "R-1", "S-1" and "T-1".

28. Said Claims for Refund filed by Plaintiffs for 1955, 1956, 1957, 1958 and 1959 were based in part on the following grounds:

(A) That raised and purchased livestock held for breeding purposes was erroneously included in their closing inventories of livestock for 1955, 1956, 1957, 1958 and 1959, respectively, and that such was erroneous for the following reasons, as set forth in the Claims for Refund.

(1) Said livestock was raised or purchased and held by the Partnership for breeding purposes and as such was used by the Partnership in conducting their trade or business;

(2) Such raised or purchased livestock so held was "property used in a trade or business of a character which is subject to the allowance for depreciation" within the meaning and intent of Sec. 1231 of the Internal Revenue Code of 1954;

(3) The term "property used in a trade or business" within the meaning and intent of Section 1231 of the Internal Revenue Code of 1954 excludes property of a kind which would be properly includible in inventory;

(4) Raised or purchased breeding animals held by the Partnership for breeding purposes are not property of a kind which would be properly includible in inventory;

[fol. 79] (5) The Partnership was not and is not required to include raised or purchased livestock held for breeding purposes in inventory;

(6) That portion of said Regulations which require the Partnership to include raised or purchased livestock held for breeding purposes in inventory were and are invalid and of no force and effect.

(7) The United States Court of Appeals, Fifth Circuit, in the case of Scofield vs. Lewis, 251 F(2) 128, affirming a decision of the United States District Court, Western Division of Texas, San Antonio Division, rendered in Civil Action No. 1998, styled A. J. Lewis, et al.,

vs. Scofield, has held that a taxpayer is not required to include livestock held for breeding purposes in inventory.

(B) That the Partnership was entitled to treat livestock purchased and held for draft, dairy or breeding purposes as capital assets subject to depreciation and the Partnership was entitled to deduct a reasonable allowance for depreciation on purchased animals held for draft, dairy or breeding purposes.

(C) That the calculation of gain upon the sale during 1955, 1956, 1957, 1958 and 1959 of raised breeding animals by using as a basis for such animals sold the accrued unit values assigned to such animals in the Partnership's inventory of livestock was erroneous in that:

(1) Such raised livestock held for breeding purposes was erroneously included in Partnership's inventory of livestock in the first instance, and consequently, the accrued unit values with respect to such animals should not have been assigned to or accrued with respect to such animals as the basis therefor.

[fol. 80] (2) Such livestock, having been raised by the Partnership, had no cost basis and for purposes of calculating the gains derived upon the sale thereof, the Partnership should have used, and was required to use, a zero basis for such animals.

(D) That the calculation of gain upon the sale during 1957, 1958 and 1959 of purchased breeding animals which were included in the Partnership's inventory of livestock by the Commissioner of Internal Revenue by using as the basis for such animals sold the unit values assigned to such animals in the Partnership's inventory of livestock was erroneous in that:

(1) Such purchased livestock held for breeding purposes was erroneously included in the Partnership's inventory of livestock in the first instance and consequently, the accrued unit values with respect to such animals should not have been assigned to or accrued with respect to such animals as the basis therefor;

(2) Such livestock, having been purchased by Partnership had a basis equal to their cost and for purposes of calculating the gains derived from the sale thereof,

the Partnership should have used and was required to use the cost of such animals, less the depreciation taken with respect thereto, as the basis for such animals.

29. The Commissioner of Internal Revenue denied and disallowed the Partnership's Claim for Refund for 1955, and 1956 on February 17, 1960, and denied and disallowed Plaintiffs' Claim for Refund for 1957, 1958 and 1959 on July 17, 1962.

30. The Partnership has not at any time filed a request for a change in their accounting method with the [fol. 81] Commissioner of Internal Revenue, and the Commissioner has given no consent to a change in Plaintiffs' accounting method.

31. It was the policy of the Commissioner of Internal Revenue not to consider requests filed by ranchers to change their method of accounting for Federal income tax purposes from the accrual (inventory) method to the cash receipts and disbursements method until the final Regulations under Sec. 481 of the Internal Revenue Code of 1954 were issued.

32. The Partnership has taken ordinary deductions for the cost of raising and maintaining raised livestock. The Partnership has taken ordinary deduction for the cost of maintaining purchased livestock.

/s/ ELWOOD CLUCK
Attorney for Plaintiffs

/s/ JOHN A. BAILEY
Attorney for Defendant

[fols. 82-114] * * *

Exhibit R to Stipulation of Facts

FORM 843 (Rev. Mar. 1960)

U. S. TREAS DEPARTMENT - INTERNAL REVENUE SERVICE

CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

District Director's Stamp (Date received)

The District Director will indicate in the block below the kind of claim filed, and fill in, where required.

- [x] Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- [ ] Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- [ ] Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

PLEASE TYPE OR PRINT PLAINLY

Name of taxpayer or purchaser of stamps

W. H. and MATTYE G. WARDLAW

Number and street: Box 1118

City, town, postal zone, State: Del Rio, Texas

Fill in applicable items—Attach letter size sheets if space is not sufficient

1. Social security number:

2. If an employer, enter employer identification number:

3. District in which return (if any) was filed: 1st District of Texas, Austin, Texas

4. Name and address shown on return, if different from above: Same

5. Period—if for tax reported on annual basis, prepare separate form for each taxable year: From January 1, 19 57 To December 31, 19 57

6. Kind of tax: Income

7. Amount of assessment: $ 6,760.37

Dates of payment:

8. Date stamps were purchased from Government:

9. Amount to be refunded: $ 6,760.37*

10. Amount to be abated (not applicable to income, estate, or gift taxes): $

11. The claimant believes that this claim should be allowed for the following reasons:

*Or such greater or lesser amount as may be legally refundable, plus interest.

See statement attached.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed W. H. WARDLAW

Dated April 30, 19 62 MATTYE G. WARDLAW

INSTRUCTIONS

1. The claim must set forth in detail each ground upon which it is made and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. If a joint income tax return was filed for the year for which this claim is filed, enter social security and employer identification number, if any, of both husband and wife and each must sign this claim even though only one had income.

3. Whenever it is necessary to have the claim executed by an agent on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent to sign the claim on behalf of the taxpayer shall accompany the claim.

4. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

5. Where the taxpayer is a corporation, the claim will be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

6. If claim is for excess social security (F.I.C.A.) tax withheld as a result of having had more than one employer, include the names and addresses of your employers, and the amount of wages received and taxes withheld by each as part of your explanation in item 11. Do not claim tax withheld if you have claimed the excess withholding on your individual income tax return.

Exhibit R 435

FORM 843 (Rev. 3-60)

[fol. 115]

[fol. 116]

LIVESTOCK INVENTORY AND RELATED MATTERS:

The Taxpayer is a partner in the partnership of Wardlaw Brothers, which conducts a ranching business consisting of breeding and raising sheep, goats, cattle and horses, principally for the production of wool, mohair, mutton, calves and colts. During the taxable year 1957, the partnership carried its livestock held for sale on an inventory basis and valued such livestock under the unit livestock price method, but did not include within such inventory the livestock constituting the breeding herds and held for breeding purposes. Upon audit of the partnership return for said year, the field agent required the partnership to include in its livestock inventory the raised, and also the purchased, livestock held for breeding purposes and to value same in accordance with the unit livestock price method, and further required the partnership to assign as cost basis for the purpose of computing gain on the sale of such raised breeding animals, the accrued unit value thereof as reflected in such inventory, such being erroneous in that:

(a) Livestock raised and held by the partnership for breeding purposes constituted property used in its trade or business within the meaning of Section 1231, I.R.C.

(b) Property used in a trade or business is not property of a kind which would be properly includible in inventory.

(c) The provisions of Regulation 39.22(c)-6 (2)(f) as amended by TD 5423, 1945, CB-70, are contradictory to the provisions of Section 1231, I.R.C. and are invalid. Scofield vs. Lewis, 251 F(2) 128.

[fol. 117] (d) Livestock purchased for draft, dairy or breeding purposes had a basis equal to its cost and for purpose of calculating gain on the sale thereof, the partnership is required to use as its basis the depreciated cost of such animals. Raised livestock held for draft, dairy or breeding purposes had no cost basis and, for purposes of calculating gain on the sale thereof, the partnership is required to use a zero basis for such animals.

(e) The partnership was not and is not required to use as the basis the accrued unit values thereof as reflected in such inventory in computing gain on the sale of raised or purchased breeding animals.

The partnership was entitled to elect, and did elect, to treat livestock purchased and held for draft, dairy or breeding purposes as capital assets subject to depreciation; and the partnership is entitled to deduct a reasonable allowance for depreciation on purchased animals held for draft, breeding or dairy purposes.

The partnership claimed depreciation on certain improvements, equipment, automobiles and trucks. Upon audit of the return, the Field Agent disallowed depreciation thereon in the aggregate amount of $3,049.16, upon the ground that such was excessive, which was erroneous in that the partnership correctly computed, claimed and was entitled to deduct depreciation upon such improvements, equipment, automobiles and trucks, as set forth in said return.

GUARANTY FUND DEDUCTION:

On June 19, 1957, the Del Rio National Bank closed by order of the Comptroller of Currency, as a result of [fol. 118] shortages and other discrepancies and its affairs were placed in the hands of the FDIC for liquidation. The partners of said partnership believed that the closing of the Bank would precipitate a financial crash with severe detrimental effects upon the partnership's ranching business. In order to protect and preserve its ranching business, the partnership, during the period June 19, 1957 and July 2, 1957, joined with other persons to rehabilitate the Bank under a plan approved by the Comptroller of Currency whereby a Guaranty Fund was created, cash contributions thereto were provided for and the funds thus obtained were used to acquire assets deemed objectionable by the Comptroller of Currency from the Bank in order that the Bank could be rehabilitated. The Guaranty Fund was to be administered by Trustees for a period of two years, and upon termination on June 19, 1959, the contributions to the Guaranty Fund, less the losses sustained during such period, were to be re-

turned to the contributors. The partnership contributed $122,975.00 to the Guaranty Fund. On July 3, 1957, the plan of rehabilitation was consummated and the Bank was reopened.

At the close of 1957, it was determined that the contributors to the Guaranty Fund, including the partnership, had sustained a net loss of $57.82% of their contributions to the Guaranty Fund and the partnership deducted such proportion of its contribution in its income tax return for 1957. Upon audit of its return, the Field Agent disallowed the deduction, which action was subsequently affirmed upon review.

The partnership is entitled to deduct in full the total amount of $122,975.00 contributed to the Guaranty Fund [fol. 119] in 1957 in that such expenditure was made by the partnership for the purpose of promoting or protecting its business and same constitutes an ordinary and necessary expense paid during the taxable year in carrying on its trade or business within the meaning of I.R.C., Sec. 162(a), or in the alternative, that it is entitled to deduct the net loss sustained in 1957 in the amount of 57.82% of its contribution to the Guaranty Fund, upon the grounds that same constitutes a loss not compensated by insurance or otherwise within the meaning of I.R.C., Sec. 165(a).

By reason of the erroneous treatment of said livestock and the erroneous disallowance of such depreciation in calculating the partnership income, all as is more particularly hereinabove set forth, Taxpayer's income was erroneously calculated in his individual income tax return and Taxpayer is, therefore, entitled to refund as hereinabove and hereinbelow stated.

There is attached hereto Schedule and computations for Taxpayer and said partnership, to which reference is here made for all purposes, showing the following:

Column 1. Computation of partnership income and Taxpayer's taxable income and tax as reflected in the partnership and Taxpayer's income tax returns as filed.

Column 2. Adjustments made thereto by the field agent upon audit.

Column 3. Partnership income and Taxpayer's taxable income and tax as adjusted by field agent upon audit.

[fol. 120]

Column 4. Adjustments claimed by Taxpayer in the claim for refund.

Column 5. Partnership income and Taxpayer's taxable income and tax as claimed in this claim for refund.

Said Schedule and computations attached hereto are incorporated herein and made a part of this Claim for Refund.

Addenda to Claim for Refund in re Livestock Inventories:

Taxpayer is entitled to recast the livestock inventory for the year covered by this Claim for Refund and for the years prior thereto, which are open and subject to adjustment, and for all years subsequent thereto, and to remove from both the opening and closing inventories all raised livestock held for breeding purposes and erroneously included therein. In connection with the opening inventory of the earliest year which is open and subject to adjustment (including the year covered by this Claim for Refund, if it be the earliest year open and subject to adjustment), Taxpayer is entitled to a deduction against ordinary income in an amount equal to the accrued unit values of all raised livestock held for breeding purposes therefore erroneously included in such inventory, or, in the alternative, Taxpayer is entitled to amortize an amount equal to the accrued unit values of all raised livestock held for breeding purposes theretofore erroneously included in such inventory, over a period not in excess of five years.

W. H. and Mattye C. Wardlaw (2)

Taxable income and tax
Year ended December 31, 1957

W. P. No.	57-1
ACCOUNTANT	HW
DATE	12/2/58

	Per Return	Difference	Per R.A.R.	Difference	Per claim
Income:					
Director fees, Del Rio National Bank	600 00	-	600 00	-	600 00
Dividends	609 95	⟨306 90⟩	303 05	-	303 05
Interest	275 00	1154 87	1429 87	-	1429 87
Capital gains or ⟨losses⟩	4906 15	⟨5211 73⟩	4284 42	5116 09	9400 51
Rents and royalties	14 21	-	14 21	-	14 21
Estates and trusts:					
C. W. Pritchard	264 35	-			
C. G. Wardlaw	249 51	-			
	501 245	⟨309 48⟩	4703 17		4703 17
Partnerships:					
Wardlaw Brothers	⟨31644 22⟩	16956 97	14312 75	⟨40512 85⟩	⟨26200 10⟩
Jennings ranch	1101 58	-	1101 58		1101 58
Other sources	232 52	-	232 52		232 52
Adjusted gross income	⟨18992 16⟩	25915 73	26981 57	⟨35396 76⟩	⟨8415 19⟩
Deductions and exemptions:					
Standard or itemized deduction	- 0 -	⟨1000 00⟩	⟨1000 00⟩	1000 00	- 0 -
Personal exemptions	- 0 -	⟨2400 00⟩	⟨2400 00⟩	2400 00	- 0 -
Taxable income	⟨18992 16⟩	22515 73	23581 57	⟨31996 76⟩	⟨8415 19⟩
Taxes:					
Income tax	- 0 -	664 00	664 00	⟨664 00⟩	- 0 -
Self employment tax	- 0 -	141 75	141 75	⟨141 75⟩	- 0 -
Dividends received credit	- 0 -	⟨22 38⟩	⟨22 38⟩	⟨22 38⟩	- 0 -
Balance of tax	- 0 -	676 37	676 37	⟨676 37⟩	- 0 -

Wardlaw Brothers, A Partnership (TP)
Taxable Income
Year ended December 31, 1957

W. P. No.	57-1
ACCOUNTANT	[illegible]
DATE	9/21/61

	Per Return	Difference	Per R.A.R.	Difference	Per Claim	
Profit or (loss) from business:						
Sales	23277660	1225 00	23106160	–	23106160	
Less cost of goods sold:						
Inventory at beginning of year	20653700	1266285	21919985	(1366385)	3469600	
Purchases	24000		24000	–	24000	
	20677700	1266285	21943985	(1366385)	3493600	
Less inventory at end of year	20387615	529429	21651044	(1956924)	6105120	57-3
Cost of goods sold	290085	(1030144)	(37010659)	1179539	(2621520)	
Gross profit	22742575	1167644	21690219	(1179539)	25727610	
Deductions:						
Depreciation - furniture	113164	(113164)	–	127399	127399	57-2
Death losses - building bond	–			1010161	1010161	57-5
Guaranty fund	71104 15	(71104 15)	–	71104 15	71104 15	
Other deductions	2487572	(101020)	2456552	–	2456552	
Total deductions	2791 00 51	(7331599)	2456852	8948675	33517227	
Net profit or (loss)	(915057)	1148992	233167	(1012814)	(779647)	
Other income:						
Interest	306509	–	306509		306509	
Rents and royalties	93012	–	93012		93012	
Ordinary income or (loss)	(791105)	1148992	357887	(1012814)	(655026)	
Partners share of ordinary income:						
Walter H. Wardlaw 40%	(316442)	459597	143155	(405126)	(262010)	
Crawford W. Wardlaw 40%	(316442)	459597	143155	(405126)	(262010)	
Trust #1, for Cody H. Wardlaw Jr. 10%	(79111)	114899	35788	(101282)	(65503)	
Trust #1, for Tennille Wardlaw 10%	(79111)	114899	35788	(101282)	(65503)	
	(791105)	1148992	357887	(1012814)	(655026)	
Capital gains	24162 01	(25672)	21589 76	2558044	4717520	57-4
Partners share of capital gains						
Walter H. Wardlaw 40%	9664 10	(10269)	8637 90	10232 18	18870 08	
Crawford W. Wardlaw 40%	9664 81	(10269)	8637 90	10232 18	18870 08	
Trust #1, for Cody H. Wardlaw Jr. 10%	2416 20	(2567)	2159 78	2558 04	4717 52	
Trust #1, for Tennille Wardlaw 10%	2416 20	(2567)	2159 78	2558 04	4717 52	
	24162 01	(25672)	21589 76	25580 44	47175 20	

Ex. No. 1 to Stip. of Facts

Exhibit 2 to Stipulation of Facts

FORM 843 (Rev. Mar. 1960)

U. S. TREA' DEPARTMENT - INTERNAL REVENUE SERVICE

CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

District Director's Stamp (Date received)

The District Director will indicate in the block below the kind of claim filed, and fill in, where required.

- [X] Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- [ ] Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- [ ] Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

PLEASE TYPE OR PRINT PLAINLY

Name of taxpayer or purchaser of stamps
W. H. and MATTYE G. WARDLAW

Number and street
Box 1118

City, town, postal zone, State
Del Rio, Texas

Fill in applicable items—Attach letter size sheets if space is not sufficient

1. Social security number

2. If an employer, enter employer identification number

3. District in which return (if any) was filed
1st District of Texas
Austin, Texas

4. Name and address shown on return, if different from above
Same

5. Period—if for tax reported on annual basis, prepare separate form for each taxable year
From January 1, 1958 To December 31, 1958

6. Kind of tax
Income

7. Amount of assessment
$ 26,574.16

Dates of payment

8. Date stamps were purchased from Government

9. Amount to be refunded
$ 15,753.36*

10. Amount to be abated (not applicable to income, estate, or gift taxes)
$

11. The claimant believes that this claim should be allowed for the following reasons:

*Or such greater or lesser amount as may be legally refundable, plus interest.

See statement attached.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed W. H. WARDLAW

Dated April 30, 1962 MATTYE G. WARDLAW

INSTRUCTIONS

1. The claim must set forth in detail each ground upon which it is made and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. If a joint income tax return was filed for the year for which this claim is filed, enter social security and employer identification number, if any, of both husband and wife and each must sign this claim even though only one had income.

3. Whenever it is necessary to have the claim executed by an agent on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent to sign the claim on behalf of the taxpayer shall accompany the claim.

4. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

5. Where the taxpayer is a corporation, the claim will be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

6. If claim is for excess social security (F.I.C.A.) tax withheld as a result of having had more than one employer, include the names and addresses of your employers, and the amount of wages received and taxes withheld by each as part of your explanation in item 11. Do not claim tax withheld if you have claimed the excess withholding on your individual income tax return.

FORM 843 (Rev. 3-60)

Exhibit 5 341

[fol. 128]

[fol.124] Taxpayer is a partner in the partnership of Wardlaw Brothers, which conducts a ranching business consisting of breeding and raising sheep, goats, cattle and horses, principally for the production of wool, mohair, mutton, calves and colts.

During the taxable year 1957, the partnership carried its livestock held for sale on an inventory basis and valued such livestock under the unit livestock price method, but did not include within such inventory the livestock constituting the breeding herds and held for breeding purposes. Upon audit of the partnership's return for the taxable year 1957, the field agent required the partnership to include in its livestock inventory the raised and also the purchased, livestock held for breeding purposes, and to value same in accordance with the unit livestock price method, and further required the partnership to assign as cost basis for the purpose of computing gain on the sale of such raised breeding animals, the accrued unit values thereof as reflected in such inventory, all as is more fully set forth in Claim for Refund for tax year 1957, filed by taxpayer contemporanously herewith. For the taxable year 1958, the partner, pursuant to and consistent with the handling of its livestock inventory required by the field agent for the taxable year 1957, included in its livestock inventory the livestock constituting the breeding herds and held for breeding purposes, and valued same in accordance with the unit livestock price method, and assigned as cost basis for the purpose of computing gain on the sale of raised breeding animals the accrued unit values thereof as reflected in such inventory; such being done in compliance with and pursuant to instructions and requirements of the Commissioner [fol. 125] of Internal Revenue, but same being erroneous in that:

(a) Livestock raised and held by the partnership for breeding purposes constituted property used in its trade or business within the meaning of Section 1231, I.R.C.

(b) Property used in a trade or business is not property of a kind which would be properly includible in inventory.

(c) The provisions of Regulations 39.22(c)-6 (2)(f), as amended by TD 5423, 1945, CB-70, are contradictory to the provisions of Section 1231, I.R.C. and are invalid. Scofield vs. Lewis, 251 F(2) 128.

(d) Livestock purchased for draft, dairy or breeding purposes had a basis equal to its cost and for purpose of calculating gain on the sale thereof, the partnership is required to use as its basis the depreciated cost of such animals. Raised livestock had no cost basis and, for purposes of calculating gain on the sale thereof, the partnership is required to use a zero basis for such animals.

(e) The partnership was not and is not required to use as the basis the accrued unit values thereof as reflected in such inventory in computing gain on the sale of raised or purchased breeding animals.

The partnership was entitled to treat livestock purchased and held for draft, dairy or breeding purposes as capital assets subject to depreciation; and the partnership is entitled to deduct a reasonable allowance for depreciation on purchased animals held for draft, breeding or dairy purposes.

[fol. 126] The partnership raised, maintained and used a herd of horses in conducting its ranching business. In order to maintain such herd of horses at its normal size, the partnership selected and sold from such herd certain horses which had been held by the partnership at least twelve months next prior to the sale thereof, and which had been actually and substantially used for draft or breeding purposes, and reported the gain thereon as long term capital gain. Upon audit of the return, the Field Agent approved the foregoing, but on review, the Reviewing Agent treated such horses as being primarily held for sale to customers in the ordinary course of business, and adjusted the partnership income and capital gains accordingly, such being erroneous in that such horses had been held for twelve months or more next prior to the sale thereof and were held, and actually and substantially used for draft or breeding purposes, and were not primarily held for sale to customers in the ordinary course of business.

By reason of the erroneous treatment of said livestock and disallowance of the reduction for the expediture made for the Guaranty Fund in calculating the partnership income, all as is more particularly hereinabove set forth, taxpayer's income was erroneously calculated in his individual income tax return and taxpayer is, therefore, entitled to refund as hereinabove and hereinbelow stated.

There is attached hereto Schedule and computations for taxpayer and said partnership to which reference is here made for all purposes, showing the following:

[fol. 127]

Column 1. Computation of partnership income and taxpayer's taxable income and tax as reflected in taxpayer's income tax return as filed, and in the partnership's income tax return as filed.

Column 2. Adjustments made thereto by the filed agent upon audit.

Column 3. Partnership income and taxpayer's taxable income and tax as adjusted by field agent upon audit.

Column 4. Adjustments claimed by taxpayer in the claim for refund.

Column 5. Partnership income and taxpayer's taxable income and tax as claimed in this claim for refund.

Said Schedule and computations attached hereto was incorporated herein and made a part of this Claim for Refund.

[fol. 128]

Addenda to Claim for Refund in re Livestock Inventories:

Taxpayer is entitled to recast the livestock inventory for the year covered by this Claim for Refund and for the years prior thereto, which are open and subject to adjustment, and for all years subsequent thereto, and to remove from both the opening and closing inventories all raised livestock held for breeding purposes and erroneously included therein. In connection with the opening inventory of the earliest year which is open and subject to adjustment (including the year covered by this Claim for Refund, if it be the earliest year open and subject to adjustment), Taxpayer is entitled to a deduction against ordinary income in an amount equal to the accrued unit values of all raised livestock held for breeding purposes therefore erroneously included in such inventory, or, in the alternative, Taxpayer is entitled to amortize an amount equal to the accrued unit values of all raised livestock held for breeding purposes theretofore erroneously included in such inventory, over a period not in excess of five years.

W. H. and Mattye R. Wardlaw (3)
Taxable income and tax
Year ended December 31, 1958

W. P. No.	58-1
ACCOUNTANT	HW
DATE	12/8/61

	Per Return	Difference	Per RAR	Difference	Per Claim
Income:					
Director fees, Del Rio National Bank					
Dividends	106586		106586		106586
Interest	175574		175574		175574
Capital gains or (losses)	855454	(242912)	642942	528502	1171444
Rents and royalties	30067		30067		30067
Estates and trusts	272187		272187		272187
Partnerships:					
Wardlaw Brothers	4494664	629527	5124191	(3401558)	1722633
Jennings Ranch	75839		75839		75839
Other sources:					
W.R.C. Land Company	176491		176491		176491
Adjusted gross income	6217262	386815	6603877	(2865756)	3738121
Deductions and exemptions:					
Standard or itemized deductions:					
Contributions	(19935)		(19935)		(19935)
Interest	(133500)		(133500)		(123500)
Taxes	(10350)		(10350)		(10350)
Personal exemptions	(240000)		(240000)		(240000)
Taxable income	5713477	386815	6130092	(2865756)	3264336
Taxes:					
Income tax	2388925	257579	2646504	(1575336)	1072168
Self employment tax	14175		14175		14175
Dividend received credit	(4263)		(4263)		(4263)
Balance of tax	2398837	257579	2656416	(1575336)	1082080

Wardlaw Brothers, A Partnership (12)
Taxable Income
Year ended December 31, 1958

W. P. No.	58-1
ACCOUNTANT	
DATE	9/21/61

	Per Return	Difference	Per IRAir	Difference	Per Claim	
Profit or (loss) from business:						
Sales	21458297	1214559	22702856	<1214559>	21458297	
less cost of goods sold:						
Inventory at beginning of year	2343174		2343174	<179266 24>	6405120	58-3
Purchases	-0-		-0-			
Labor	487625		487625		487625	
Materials & supplies	445114		445114		445114	
Other	261176		261176		261176	
	3537091		3537091	<179266 24>	1805429	
less inventory at end of year	2708406		2708406	<2331600>	3740200	58-3
cost of goods sold	828685		828685	59873582	1432609	
Gross profit	13201512	1214559	14416071	<720394 1>	7225203	
Deductions						
Rent	275268	—	275268		275268	
Interest	203554	—	203554		203554	
Taxes	37731	—	37731		37731	
Repairs	28147	—	28147		28147	
Depreciation	2068539	<359259>	1709280	1147759	2857039	58-2
Other	145960	—	145960	15219	161179	58-6
Total deductions	8974786	<359259>	8616503	1299953	9915456	
Net profit or (loss)	4226723	1573818	5800541	<8603894>	<2703253>	
Other income:						
Interest	89607	—	89607	—	89607	
Rents and royalties	601376	—	601376	—	601376	
A.C. Program	10000	—	10000	—	10000	
Ordinary income or (loss)	11234659	1573818	12808477	<8603894>	4306583	
Partners' share of ordinary income:						
Walter H. Wardlaw 40%	4494664	629527	5124191	<3401558>	1722633	
Crawford W. Wardlaw 40%	4494664	629527	5124191	<3401558>	1722633	
Trust #1 for Cody H. Wardlaw, Jr. 10%	1123666	157382	1281047	<850389>	430658	
Trust #1 for Tennille Wardlaw 10%	1123665	157382	1281047	<850389>	430658	
	11234659	1573818	12810477	<8603894>	4306583	
Capital gains	4429269	<1214559>	3214710	2679010	5893720	58-4
Partners' share of capital gains:						
Walter H. Wardlaw 40%	1771707	<485823>	1285884	1071604	2357488	
Crawford W. Wardlaw 40%	1771708	<485824>	1285884	1071604	2357488	
Trust #1 for Cody H. Wardlaw, Jr. 10%	442927	<121456>	321471	267901	589372	
Trust #1 for Tennille Wardlaw 10%	442927	<121456>	321471	267901	589372	
	4429269	<1214559>	3214710	2679010	5893720	

✓ Exhibit T to Stipulation of Facts

✓ Exhibit T to Stipulation of Facts

FORM 843
(Rev. Mar. 1960)

U. S. TREASURY DEPARTMENT - INTERNAL REVENUE SERVICE

CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

District Director's Stamp
(Date received)

The District Director will indicate in the block below the kind of claim filed, and fill in, where required.

- [x] Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- [ ] Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- [ ] Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

PLEASE TYPE OR PRINT PLAINLY

Name of taxpayer or purchaser of stamps
W. H. and MAYME J. WARDLAW

Number and street
Box 1112

City, town, postal zone, State
Del Rio, Texas

Fill in applicable items—Attach letter size sheets if space is not sufficient

1. Social security number

2. If an employer, enter employer identification number

3. District in which return (if any) was filed
U.S. Collector of Internal Revenue
San Antonio, Texas

4. Name and address shown on return, if different from above
Same

5. Period—if for tax reported on annual basis, prepare separate form for each taxable year
From January 1, 19 59 To December 31, 19 59

6. Kind of tax
Income

7. Amount of assessment
$ 20,220.27

Dates of payment

8. Date stamps were purchased from Government

9. Amount to be refunded
$ 34,237.64*

10. Amount to be abated (not applicable to income, estate, or gift taxes)
$

11. The claimant believes that this claim should be allowed for the following reasons:

*Or such greater or lesser amount as may be legally refundable, plus interest.

See statement attached.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed W. H. Wardlaw

Dated April 30, 1962 MAYME J. WARDLAW

INSTRUCTIONS

1. The claim must set forth in detail each ground upon which it is made and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. If a joint income tax return was filed for the year for which this claim is filed, enter social security and employer identification number, if any, of both husband and wife and each must sign this claim even though only one had income.

3. Whenever it is necessary to have the claim executed by an agent on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent to sign the claim on behalf of the taxpayer shall accompany the claim.

4. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

5. Where the taxpayer is a corporation, the claim will be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

6. If claim is for excess social security (F.I.C.A.) tax withheld as a result of having had more than one employer, include the names and addresses of your employers, and the amount of wages received and taxes withheld by each as part of your explanation in item 11. Do not claim tax withheld if you have claimed the excess withholding on your individual income tax return.

FORM 843 (Rev. 3-60)

Exhibit T

[fol. 131]

[fol. 132] Taxpayer is a partner in the partnership of Wardlaw Brothers, which conducts a ranching business consisting of breeding and raising sheep, goats, cattle and horses, principally for the production of wool, mohair, mutton, calves and colts.

During the taxable year 1957, the partnership carried its livestock held for sale on an inventory basis and valued such livestock under the unit livestock price method, but did not include within such inventory the livestock constituting the breeding herds and held for breeding purposes, Upon audit of the partnership's return for the taxable year 1957, the field agent required the partnership to include in its livestock inventory the raised and also the purchased, livestock held for breeding purposes, and to value same in accordance with the unit livestock price method, and further required the partnership to assign as cost basis for the purpose of computing gain on the sale of such raised breeding animals, the accrued unit values thereof as reflected in such inventory, all as is more fully set forth in Claim for Refund for tax year 1957, filed by taxpayer contemporanously herewith. For the taxable year 1958, the partner, pursuant to and consistent with the handling of its livestock inventory required by the field agent for the taxable year 1957, included in its livestock inventory the livestock constituting the breeding herds and held for breeding purposes, and valued same in accordance with the unit livestock price method, and assigned as cost basis for the purpose of computing gain on the sale of raised breeding animals the accrued unit values thereof as reflected in such inventory; such being done in compliance with and pursuant to instructions and requirements of the Commissioner [fol. 133] of Internal Revenue, but same being erroneous and taxpayer entitled to a refund, as set forth in Claim for Refund, for the year 1958, filed contemporaneously herewith. For the taxable year 1959, the partnership, pursuant to and consistent with, the handling of its livestock inventory required by the field agent for the taxable years 1957 and 1958, included in its livestock inventory the livestock constituting the breeding herds and held for breeding purposes, and valued same in accordance

with the unit livestock price method, and assigned as cost basis for the purpose of computing gain on the sale of raised breeding animals the accrued unit value thereof as reflected in such inventory; such being done in compliance with and pursuant to instructions and requirements of the Commissioner of Internal Revenue, but same being erroneous in that:

(a) Livestock raised and held by the partnership for breeding purposes constituted property used in its trade or business within the meaning of Section 1231, I.R.C.

(b) Property used in a trade or business is not property of a kind which would be properly includible in inventory.

(c) The provisions of Regulations 39.22(c)-6 (2)(f), as amended by TD 5423, 1945, CB-70, (now Reg. 1.47-6 (f)) are contradictory to the provisions of Section 1231, I.R.C. and are invalid, *Scofield* vs. *Lewis*, 251 F(2) 128.

(d) Livestock purchased for draft, dairy or breeding purposes had a basis equal to its cost and for purpose of calculating gain on the sale thereof, the partnership [fol. 134] is required to use as its basis the depreciated cost of such animals. Raised livestock had no cost basis and, for purposes of calculating gain on the sale thereof, the partnership is required to use a zero basis for such animals.

(e) The partnership was not and is not required to use as the basis the accrued unit values thereof as reflected in such inventory in computing gain on the sale of raised or purchased breeding animals.

The partnership was entitled to treat livestock purchased and held for draft, dairy or breeding purposes as capital assets subject to depreciation; and is entitled to deduct a reasonable allowance for depreciation on purchased animals held for draft, breeding or dairy purposes.

The partnership raised, maintained and used a herd of horses in conducting its ranching business. In order to maintain such herd of horses at its normal size, the partnership selected and sold from such herd certain horses which had been held by the partnership at least twelve months next prior to the sale thereof, and which had

been actually and substantially used for draft or breeding purposes, and reported the gain thereon as long term capital gain. Upon audit of the return, the Field Agent approved the foregoing, but on review, the Reviewing Agent treated such horses as being primarily held for sale to customers in the ordinary course of business, and adjusted the partnership income and capital gains accordingly, such being erroneous in that such horses had been held for twelve months or more next prior to the sale thereof and were held, and actually and substantially used for draft or breeding purposes, and were not prim- [fol. 135] arily held for sale to customers in the ordinary course of business.

By reason of the erroneous treatment of said livestock and disallowance of the reduction for the expenditure made for the Guaranty Fund in calculating the partnership income, all as is more particularly hereinabove set forth, taxpayer's income was erroneously calculated in his individual income tax return and taxpayer is, therefore, entitled to refund as hereinabove and hereinbelow stated.

GUARANTY FUND DEDUCTION:

During the taxable year 1957, the partnership contributed the sum of $122,975.00 to the Guaranty Fund of the Del Rio National Bank under the circumstances set out in statement attached to claim for refund for 1957, filed by taxpayer contemporaneously herewith and the partnership claimed a deduction therefor which was subsequently disallowed as therein stated. The administration of the Guaranty Fund under the terms of the Indenture creating same, terminated on June 19, 1959, and at such date it was determined that a net loss in the aggregate amount of 56.7% of the contributions to the Guaranty Fund had been sustained by the contributors thereto. The partnership deducted such proportion of its contribution to the Guaranty Fund in its income tax return for 1959. Upon audit of the return for said year, the field agent disallowed the deduction which was subsequently affirmed upon review. The partnership is entitled to the deduction for the contributions to the Guaranty Fund as

set forth in its claim for refund for the year 1957 filed [fol. 136] contemporaneously herewith or, in the alternative, that is entitled to deduct 56.7% (being the amount irrevocably appropriated by the Trustees of the Guaranty Fund pursuant to the Indenture creating same) of the original contribution thereto, in that such expenditure was made by the partnership under the circumstances set forth in Claim for Refund for the year 1957, filed contemporaneously herewith, for the purpose of promoting or protecting its business and same constitutes an ordinary and necessary expense paid during the taxable year in carrying on its trade or business within the meaning of I.R.C., Sec. 162(a), or in the alternative, that the partnership is entitled to deduct a net loss sustained in 1959 in the amount of 56.7% of its contribution to the Guaranty Fund upon the ground that same constitutes a loss not compensated for by insurance or otherwise within the meaning of I.R.C. Sec. 165(a).

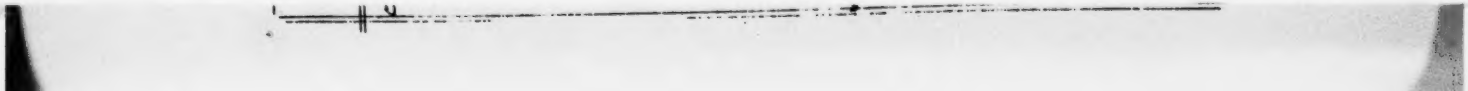
There is attached hereto Schedule and computations to which reference is here made for all purposes, showing the following:

Column 1. Computation of partnership income and taxpayer's taxable income and tax as reflected in the partnership and taxpayer's income tax return as filed.

Column 2. Adjustments made thereto by the field agent upon audit.

Column 3. Partnership income and taxpayer's taxable income and tax as adjusted by field agent upon audit.

Column 4. Adjustments claimed by taxpayer in the claim for refund.



W. H. and Hattie C. Wardlaw (2)
Taxable income and income tax
Year ended December 31, 1959

W. P. No.	59-1
ACCOUNTANT	HW
DATE	12/2/61

	Per Return	Difference	Per RAR	Difference	Per claim
Income:					
Dividends	264048		264048		264048
Interest	182593		182593		182593
Capital gains or (losses)	642139	(254539)	387600	621407	1009007
Rents and royalties	3105777		3105777		3105777
Estates and Trusts	892850		892850		892850
Partnerships:					
Wardlaw Brothers	1508701	3334240	4842941	(5931988)	(1089047)
(Farming) Ranch	90750		90750		90750
Other sources:					
W. B. C. Land Co.	357510		357510		357510
Adjusted gross income	7044368	3079701	10124069	(5310581)	4813488
Deductions and exemptions:					
Standard or itemized deductions:					
(No details)	(204318)		(204318)		(204318)
Personal exemptions	(240000)		(240000)		(240000)
Taxable income	6600050	3079701	9679751	(5310581)	4369170
Taxes:					
Income Tax	2938974	2109175	5048149	3423564	1624585
Self-employment tax	18000		18000		18000
Dividends received credit	(10562)		(10562)		(10562)
Balance of tax	2946412	2109175	5055587	(3423564)	1632023

Wardlaw & others, A Partnership (a)
Taxable Income
Year ended December 31, 1959

W. P. No.	59-1
ACCOUNTANT	(GK)
DATE	12/2/61

	Per Return	Difference	Per R.A.R.	Difference	Per Claim
Profit or (loss) from business & sales	30721969	1265194	31987163	(1265194)	30721969
Less cost of goods sold:					
Inventory at beginning of year	24268906	-	24268906	(2050706)	3768200
Purchases	-				
Labor	14041160	-	14041160	-	14041160
Materials and supplies	-				
Other	-				
	38310066	-	38310066	(2050706)	17809360
Less inventory at end of year	28346356	-	28346356	(2481136)	3534520
Cost of goods sold	9963710	-	9963710	481130	14274840
Gross profit	20758259	1265194	22023453	(5576324)	16447129
Deductions:					
Rent	3550254	-	3550254		3550254
Interest	1189309	-	1189309		1189309
Taxes	442617	-	442617		442617
Repairs	632911	-	632911		632911
Depreciation	2420048	(327687)	2092361	666963	2759324
Bad debts	674719	(674719)	- -	674719	674719
Other	277429	-	277429	1844065	4618194
Total deductions	17751987	(7070406)	10681581	9253647	19935228
Net profit or (loss)	3006272	8335600	11341872	(14829771)	(3488099)
Other income					
Miscellaneous income	390145	-	390145	-	390145
Interest	375336	-	375336	-	375336
Ordinary income or (loss)	3771753	8335600	12107353	(14829771)	(2722618)
Partners share of ordinary income:					
Walter H. Wardlaw 40%	150870 1	333424 0	484294 1	(593198 8)	(108904 7)
Crawford W. Wardlaw 40%	150870 1	333424 0	484294 1	(593198 8)	(108904 7)
Trust #1 for Tennille Wardlaw 20%	75435 1	166712 0	242147 1	(296599 5)	(54452 34)
	3771753	8335600	12107353	(14829771)	(2722618)
Capital gains	337052 0	(126519 4)	2105326	3107034	512360
Partners share of capital gains:					
Walter H. Wardlaw 40%	134820 8	(50607 7)	842131	124281 3	2084944
Crawford W. Wardlaw 40%	134820 8	(50607 7)	842131	124281 3	2084944
Trust #1 for Tennille Wardlaw 20%	67410 4	(25304 0)	421064	62140 8	1042972
	337052 0	(126519 4)	2105326	3107034	512360

[fol. 139]

Column 5. Partnership income and taxpayer's tax able income and tax as claimed in this claim for refund.

Said Schedule and computations attached hereto was incorporated herein and made a part of this Claim for Refund.

Addenda to Claim for Refund in re Livestock Inventories:

Taxpayer is entitiled to recast the livestock inventory for the year covered by this Claim for Refund and for the years prior thereto, which are open and subject to adjustment, and for all years subsequent thereto, and to remove from both the opening and closing inventories all raised livestock held for breeding purposes and erroneously included therein. In connection with the opening inventory of the earliest year which is open and subject to adjustment (including the year covered by this Claim for Refund, if it be the earliest year open and subject to adjustment), Taxpayer is entitled to a deduction against ordinary income in an amount equal to the accrued unit values of all raised livestock held for breeding purposes therefore erroneously included in such inventory, or, in the alternative, Taxpayer is entitled to amortize an amount equal to the accrued unit values of all raised livestock held for breeding purposes theretofore erroneously included in such inventory, over a period not in excess of five years.

[fol. 140]

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
DEL RIO DIVISION

CIVIL ACTION

No. 307

W. H. WARDLAW and wife, MATTYE GWEN WARDLAW, PLAINTIFFS

vs.

UNITED STATES OF AMERICA, DEFENDANT

FINAL JUDGMENT—January 31, 1964

All of the issues involved in the above numbered and entitled cause with respect to the determination of Plaintiffs' inventory of livestock and the calculation of gain upon the sale of livestock held for breeding purposes having been by order of this Court severed from the other issues involved therein for trial separately by the Court without a jury, same came on for consideration in the United States District Court for the Western District of Texas, Del Rio Division, sitting in San Antonio, Texas, on the 3rd day of May, 1963, upon Plaintiffs' Motion for Summary Judgment, and Defendant's Motion for Summary Judgment, and the Court having considered the pleadings filed in this action, the Stipulations of Fact entered into between Plaintiffs and Defendant, the respective Motions for Summary Judgments filed herein by Plaintiffs and by Defendant, and the written briefs and oral argument of Plaintiffs and Defendant submitted in support thereof, and the Court being fully advised in the premises and there being no dispute as to any material fact, the Court made and filed its Findings of Fact and [fol. 141] Conclusions of Law herein, expressly directing that judgment be entered herein in accordance therewith, and there being no just reason for the delay in the entry of judgment herein;

It is THEREFORE ORDERED, ADJUDGED and DECREED that Plaintiffs' Motion for Summary Judgment with respect to raised animals held for breeding purposes be and the same is hereby granted, but insofar as same relates to purchased animals held for breeding purposes, Plaintiffs' Motion for Summary Judgment be, and the same is hereby denied; and

It is further ORDERED, ADJUDGED and DECREED that Defendant's Motion for Summary Judgment with respect to raised animals held for breeding purposes be and the same is hereby denied, but insofar as same relates to purchased animals held for breeding purposes, Defendant's Motion for Summary Judgment be and the same is hereby granted; and

It is further ORDERED, ADJUDGED and DECREED by the Court that Plaintiffs W. H. WARDLAW and wife, MATTYE GWEN WARDLAW, do have and recover from Defendant, the UNITED STATES of AMERICA the sum of $39,798.68 (which sum represents overpayment of income tax for Plaintiffs' taxable years 1957, 1958 and 1959) with interest at the rate of 6% per annum on the amount of $6,760.37 from April 15, 1958; on the amount of $21,288.00 from April 15, 1959; and on the [fol. 142] amount of $11,750.31 from April 15, 1960, together with all allowable costs of suit expended by Plaintiffs herein.

DONE and ENTERED this the 31st day of January 1964.

/s/ ADRIAN A. SPEARS
U. S. District Judge

Approved as form

WILLIAM O. MURRAY, JR.
1st Asst. U. S. Attorney

* * * *

[fol. 143]

IN THE UNITED STATES DISTRICT COURT,
WESTERN DISTRICT OF TEXAS
DEL RIO DIVISION

CIVIL ACTION

No. 307

W. H. WARDLAW and wife MATTYE GWEN WARDLAW
PLAINTIFF

vs.

UNITED STATES OF AMERICA, DEFENDANT

NOTICE OF APPEAL

Notice is hereby given that the defendant herein hereby appeals to the United States Court of Appeals for the Fifth Circuit from the final judgment entered in this action on January 31, 1964.

ERNEST MORGAN
United States Attorney

By: /s/ TED BUTLER
TED BUTLER
Assistant U. S. Attorney
Post Office Box 1701
San Antonio, Texas, 78206

[fol. 144]

CERTIFICATE OF SERVICE BY MAIL

This is to certify that a copy of the foregoing Notice of Appeal has been served on opposing counsel by depositing a copy of same in the United States Mails, postage prepaid, addressed to Mr. Elwood Cluck, attorney at Law, 2100 National Bank of Commerce Building, San Antonio, Texas, on this the 27th day of March, 1964.

/s/ TED BUTLER
TED BUTLER
Assistant U. S. Attorney

[fols. 145-152] * * *

[fol. 153]

MINUTE ENTRY OF ARGUMENT AND SUBMISSION—
January 6, 1965.

(Omitted in Printing)

[fol. 154]

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 21607

UNITED STATES OF AMERICA, APPELLANT-APPELLEE

vs.

W. H. WARDLAW, Independent Executor of the Estate of C. H. Wardlaw, Deceased, ET AL., APPELLEES-APPELLANTS

(AND REVERSE TITLE)

Appeals from the United States District Court for the Western District of Texas.

OPINION—April 8, 1965.

Before MARIS,* RIVES and BROWN, Circuit Judges.

PER CURIAM: This appeal and cross appeal presents Taxpayer's and the Government's dissatisfaction with the trial Court's disposition of the tax refund suit. We affirm.

[fol. 155] At issue is the proper income tax treatment of *raised* breeding animals and *purchased* breeding animals owned by an accrual basis Taxpayer-Rancher.

The Government's appeal concerns *raised* breeding animals.[1] The District Court followed our opinion in *Scofield* v. *Lewis*, 1958, 251 F.2d 128, which held that Treasury

---

* Of the Third Circuit, setting by designation.

[1] The same issue is now pending before another panel of this Court in United States v. Catto, No. 21351, 1965, . . . F.2d . . .

Regulation 1.471-6(f) was invalid. Despite the doubts generated by express rejection of *Lewis* by the 8th and 9th Circuits,[2] a somewhat restricted reading of it by us in *Carter* v. *Commissioner*, 5 Cir., 1958, 257 F.2d 595, and the impressive conceptual arguments perhaps not fully advanced earlier, we recognize that *Lewis* is directly in point and is, and must be, controlling until the principle is judicially reversed or legislatively repealed.[3]

The Taxpayer's appeal concerns *purchased* breeding animals. Accrual basis livestock farmers under Treas. [fol. 156] Reg. 1.471-6(g) (1954 Code) are given an option to include in inventory their purchased breeding animals, or to treat them as capital assets subject to depreciation. Taxpayer here, prior to 1957, had been including purchased animals in inventory, but, without the Commissioner's consent, elected in the years 1957, 1958, 1959 to exclude purchased animals from inventory so as to (a) depreciate their cost basis and (b) upon sale report capital gain against depreciated cost rather than inventory value. The District Court sustained the Commissioner's refusal to permit this.

The difference between Taxpayer and the Government is a narrow one. Taxpayers recognize that the option has to be exercised and that once exercised as to a particular animal, that animal cannot be changed from inventory to depreciable asset, or vice versa. The Government urges that it is the practice with respect to the herd. We agree.

---

[2] United States v. Ekberg, 8 Cir. 1963, 291 F.2d 913; Banks v. Commissioner, 8 Cir. 1963, 322 F.2d 530, 546-47; Little v. Commissioner, 9 Cir., 1963, 294 F.2d 661; see also Irvine v. Commissioner, D.C. Wyo., 1963, 212 F.Supp. 937.

[3] Congress, at least since 1952, has been aware of many of these problems. See letter of June 27, 1952, from Secretary of the Treasury to Senator George, Chairman of the Senate Finance Committee, 98 Cong. Record, part 6, pp. 8307-8308. One complicating factor is the practice, recognized by formal regulations by which both accrual and cash basis taxpayers may deduct the cost of feeding, raising and maintaining animals as ordinary and necessary business expense rather than treating them as capital expenditure for the "acquisition" of a capital asset, i.e., a mature animal. Treasury Regulation 1.162-12. This regulation, with only slight terminology changes, goes back to 1921. See, e.g., Regulation 45, Art. 110, for the year 1921; Reg. 101, Art. 23(a)-11, for the year 1936.

The Regulations, § 1.61-4(b)[4] require a consistency from year to year and as such represent a valid exercise of the Commissioner's power to prescribe reasonable accounting methods, *Cf. Carter* v. *Commissioner*, 5 Cir., 1958, 257 F.2d 595. We are not impressed with Taxpayer's argument that it was 1960 before it was learned for the first time that only one election is afforded. The Regulation is plain and administratively reasonable. [fol. 157] "There is no evidence that Ruling 60-60 departed from any prior construction of the applicable statutes and regulations." *Tee Bar Ranch Co.* v. *United States*, D. Mont., 1963, 63-2 USTC #9663, at 98,681 and authority there collected.

AFFIRMED.

---

[4] § 1.61-4(b). "A farmer using accrual method of accounting must use inventories to determine his gross income * * *. Livestock acquired for draft, breeding, or dairy purposes and not for sale may be included in the inventory * * * instead of being treated as capital assets subject to depreciation, provided such practice is followed consistently from year to year by the taxpayer. * * *."

[fol. 158]

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1964

No. 21607

D. C. Docket Nos. 306, 307, 328, 329, 330, 331, 332 and 333-C. A.

UNITED STATES OF AMERICA, APPELLANT-APPELLEE

versus

W. H. WARDLAW, INDEPENDENT EXECUTOR OF THE ESTATE OF C. H. WARDLAW, DECEASED, ET AL., APPELLEES-APPELLANTS

(AND REVERSE TITLE)

Appeal from the United States District Court for the Western District of Texas.

Before MARIS,* RIVES and BROWN, Circuit Judges.

JUDGMENT—April 8, 1965

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel;

---

* Of the Third Circuit, sitting by designation.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

Issued as Mandate: May 3, 1965

[fol. 159]

[Clerk's Certificate to foregoing transcript omitted in printing]

[fol. 160]

SUPREME COURT OF THE UNITED STATES

No. ————, October Term, 1965

UNITED STATES, PETITIONER

v.

JOHN CATTO, JR., and ROXANA CATTO

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—July 2, 1965

UPON CONSIDERATION of the application of counsel for petitioner,

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including August 6, 1965.

/s/ Hugo L. Black
Associate Justice of the Supreme Court of the United States

Dated this 2nd day of July, 1965

[fol. 161]

SUPREME COURT OF THE UNITED STATES

No. ————, October Term, 1965

UNITED STATES, PETITIONER

v.

W. H. WARDLAW, INDEPENDENT EXECUTOR OF THE ESTATE OF C. H. WARDLAW, DECEASED, ET AL.

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—July 2, 1965

UPON CONSIDERATION of the application of counsel for petitioner,

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including August 6, 1965.

/s/ Hugo L. Black
Associate Justice of the Supreme
Court of the United States

Dated this 2nd day of July, 1965

[fol. 162]

SUPREME COURT OF THE UNITED STATES

No. ————, October Term, 1965

UNITED STATES, PETITIONER

vs.

JOHN CATTO, JR. AND ROXANA CATTO, HIS WIFE.

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—July 30, 1965

UPON CONSIDERATION of the application of counsel for petitioner,

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby, further extended to and including Sept. 5, 1965.

/s/ Hugo L. Black
Associate Justice of the Supreme
Court of the United States

Dated this 30th day of July, 1965

[fol. 163]

SUPREME COURT OF THE UNITED STATES

No. ———, October Term, 1965

UNITED STATES, PETITIONER

vs.

W. H. WARDLAW, INDEPENDENT EXECUTOR OF THE ESTATE OF C. H. WARDLAW, DECEASED, ET AL.

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—July 30, 1965

UPON CONSIDERATION of the application of counsel for petitioner,

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby further extended to and including Sept. 5, 1965.

/s/ Hugo L. Black
Associate Justice of the Supreme Court of the United States

Dated this 30th day of July, 1965

[fol. 164]

SUPREME COURT OF THE UNITED STATES

No. 535, October Term, 1965

UNITED STATES, PETITIONER

v.

JOHN CATTO, JR., ET AL.

ORDER ALLOWING CERTIORARI—November 22, 1965.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1965 797083 417